No. 90-1156-CFX
Status: DONE

Title: New Orleans Public Service Inc., Petitioner
v.
Council of the City of New Orleans, et al.

Docketed:
January 15, 1991

Court: United States Court of Appeals
for the Fifth Circuit

Counsel for petitioner: Lee,Rex E., Carpenter,David W.

Counsel for respondent: Jones II,Okla, Vince,Clinton A., Gelfand,M.David

40 copies mailed 1/15 and recd. 1/17.

Entry	Date	Note	Proceedings and Orders
1	Jan 15 1991	N	Petition for writ of certiorari filed.
2	Feb 11 1991		Brief amici curiae of United States and FERC filed.
3	Feb 13 1991		Brief amicus curiae of Edison Electric Insitutue filed.
5	Feb 15 1991		Order extending time to file response to petition until March 25, 1991.
6	Mar 25 1991		Brief of respondents Council of the City of New Orleans, et al. in opposition filed.
8	Mar 25 1991		Lodging filed.
9	Mar 27 1991		DISTRIBUTED. April 12, 1991
10	Apr 3 1991	X	Reply brief of petitioner New Orleans Public Service Inc. filed.
11	Apr 5 1991	X	Supplemental brief of petitioner New Orleans Public Service Inc. filed.
13	Apr 5 1991	X	Supplemental brief of respondents Council of City of New Orleans, et al. filed.
14	Apr 11 1991	X	Supplemental brief of respondent Council of the City of New Orleans (Second Supplement) filed.
16	Apr 15 1991		REDISTRIBUTED. April 19, 1991
17	Apr 22 1991		Petition GRANTED.
			**********
19	May 2 1991		Order extending time to file brief of petitioner on the merits until July 3, 1991.
20	May 3 1991		Record filed.
		*	certified copy of C.A. proceedings.
21	May 15 1991		Record filed.
		*	certified copy of original record on appeal (3 Boxes). 2 additional boxes received 5/16/91.
22	Jul 3 1991		Brief amicus curiae of American Gas Association filed.
23	Jul 3 1991		Brief amicus curiae of Edison Electric Insitutue filed.
24	Jul 3 1991		Brief of petitioner New Orleans Public Service Inc. filed.
25	Jul 3 1991		Brief amici curiae of United States and FERC filed.
26	Jul 3 1991		Joint appendix filed.
27	Jul 5 1991		Lodging received, 10 copies.
29	Jul 5 1991		Order extending time to file brief of respondent on the merits until September 6, 1991.
30	Jul 12 1991	G	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
31	Jul 19 1991	D	Motion of respondent Alliance for Affordable Energy,

No. 90-1156-CFX

Entry	Date	Note	Proceedings and Orders
			Inc. for divided argument and for additional time for oral argument filed.
32	Jul 19 1991		Opposition of respondent Council of City of New Orleans to motion of respondent Alliance for Affordable Energy, Inc. for divided argumen filed.
35	Sep 4 1991		Brief amicus curiae of National Assn. of State Utility Consumer Advocates filed.
33	Sep 6 1991		Brief of respondent Alliance for Affordable Energy filed.
34	Sep 6 1991		Brief of respondents Council of the City of New Orleans, et al. filed.
36	Sep 6 1991		Brief amicus curiae of National Association of Regulatory Utility Commissioners filed.
37	Sep 6 1991		Brief amici curiae of PUC of Californa, et al. filed.
38	Sep 13 1991		Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
39	Sep 13 1991		Motion of respondent Alliance for Affordable Energy, Inc. for divided argument and for additional time for oral argument DENIED.
41	Oct 9 1991		Reply brief of petitioner New Orleans Public Service Inc. filed.
40	Oct 11 1991		CIRCULATED.
42	Oct 15 1991		SET FOR ARGUMENT MONDAY, DECEMBER 2, 1991. (4TH CASE)
43	Oct 18 1991		Letter from Counsel for the respondents received and distributed.
44	Nov 7 1991		DISMISSED under Rule 46.
			**********

90-1156

Supreme Court, U.S.
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JOSEPH F. SPANIOL, JR.
CLERK

No. 90-_____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

NEW ORLEANS PUBLIC SERVICE INC.,

Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, JOSEPH I. GIARRUSSO, LAMBERT C. BOISSIERE, JR., MICHAEL EARLY, JAMES SINGLETON, DOROTHY MAE TAYLOR, JOHNNY JACKSON, and PEGGY WILSON,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

This case presents a recurring question under the Federal Power Act that has been decided in sharp conflict with this Court's prior decisions and with the decisions of the Massachusetts, North Dakota and Minnesota Supreme Courts:

> Whether states or municipalities have jurisdiction, subject only to state substantial evidence requirements, to nullify FERC's wholesale rate decisions by deciding it was "imprudent" for a utility to fail to "minimize its losses" during construction of a wholesale generating facility and by barring recovery of, and thereby "trapping," wholesale costs that FERC found to be "just and reasonable" and ordered the utility to incur?

RULE 29.1 STATEMENT

Petitioner New Orleans Public Service Inc. ("NOPSI") is a wholly-owned subsidiary of Entergy Corporation ("Entergy"). Entergy has no parent company, and neither Entergy nor NOPSI has any subsidiaries that are not wholly-owned by Entergy either directly or through other wholly-owned subsidiaries.

TABLE OF CONTENTS

	Page
Question Presented	i
Rule 29.1 Statement	ii
Table of Authorities	iv
Opinions Below	1
Jurisdiction	1
Constitutional And Statutory Provisions	2
Statement Of The Case	2
Reasons For Granting The Petition	11
I. The Fifth Circuit's Decision Conflicts With *MP&L*, *Nantahala*, And Other Decisions Of This Court	12
II. The Fifth Circuit's Decision Conflicts With Decisions Of The Massachusetts, Minnesota, And North Dakota Supreme Courts And With The Decisions Of FERC And Several Federal Courts Of Appeals	17
III. Resolution Of This Conflict Is A Matter Of Great National Importance	21
Conclusion	23
Appendix	
Court Of Appeals Opinion	1A
District Court Opinion And Order	25A
Court Of Appeals Order Denying Petition For Rehearing	33A
Excerpts From The Federal Power Act	35A
Excerpts From The Constitution Of The United States	45A

TABLE OF AUTHORITIES

Cases:	Page(s):
Anaheim, Riverside v. *FERC*, 669 F.2d 799 (D.C. Cir. 1981)	18
Appeal of Sinclair Machine Products, Inc., 498 A.2d 696 (N.H. 1985)	21
Arkansas Electric Coop. Corp. v. *Arkansas Public Service Commission*, 461 U.S. 375 (1983)	12
Arkansas Louisiana Gas Co. v. *Hall*, 453 U.S. 571 (1981)	13
Chicago & N.W. Transport Co. v. *Kalo Brick & Tile Co.*, 450 U.S. 311 (1981)	13
City of New Orleans v. *FERC*, 875 F.2d 903 (D.C. Cir. 1989), *cert denied*, 110 S. Ct. 1805 (1990)	7
Eastern Edison Co. v. *Department of Public Utilities*, 446 N.E.2d 684 (Mass. 1983)	3, 19
Embry v. *Palmer*, 107 U.S. 3 (1882)	11
English v. *General Electric Co.*, 110 S. Ct. 2270 (1990)	17
FPC v. *Southern California Edison Co.*, 376 U.S. 205 (1964)	13
Hunter v. *Underwood*, 471 U.S. 222 (1985)	17
Kentucky Power Co. v. *Kentucky Public Service Comm'n*, No. 86-CA-1031-MR (Kentucky Court of Appeals, June 2, 1988)	20
Kentucky West Virginia Gas Co. v. *Pennsylvania Public Utility Commission*, 837 F.2d 600 (3d Cir. 1988)	20

	Page(s):
Kentucky West Virginia Gas Co. v. *Pennsylvania Public Utility Commission*, 862 F.2d 69 (3d Cir. 1988)	20
Maryland v. *Louisiana*, 451 U.S. 725 (1981)	13
Minnesota v. *FERC*, 734 F.2d 1286 (8th Cir. 1984)	18
Mississippi ex rel. Pittman v. *Mississippi Public Service Commission*, 506 So. 2d 978 (1987)	14
Mississippi Industries v. *FERC*, 808 F.2d 1525 & 822 F.2d 1103 (D.C. Cir. 1987)	7
Mississippi Power & Light Co. v. *Mississippi ex rel. Moore*, 487 U.S. 354 (1988)	*passim*
Montana-Dakota Utilities Co. v. *Northwestern Public Service Co.*, 341 U.S. 246 (1951)	13
Moses H. Cone Memorial Hospital v. *Mercury Construction Corp.*, 460 U.S. 1 (1983)	1
NOPSI v. *Council of New Orleans*, 109 S. Ct. 2506 (1989)	*passim*
Nantahala Power & Light Co. v. *Thornburg*, 476 U.S. 953 (1986)	*passim*
Northern Natural Gas Co. v. *State Corp. Commission of Kansas*, 372 U.S. 84 (1963)	13
Northern States Power Co. v. *Hagen*, 314 N.W.2d 32 (N.D. 1981)	3, 19, 20
Northern States Power Co. v. *Minnesota Public Utilities Commission*, 344 N.W.2d 374 (Minn. 1984)	3, 20
Pacific Gas & Electric Co. v. *State Energy Resources Conservation and Development Commission*, 461 U.S. 190 (1983)	17

	Page(s):
Palmer v. *BRG of Georgia, Inc.*, 111 S. Ct. 401 (1990)	11, 23
Palmer v. *Thompson*, 403 U.S. 217 (1971)	17
Pike County Light & Power Co. v. *Pennsylvania Public Utility Commission*, 465 A.2d 735 (Penn. Commwlth Ct. 1983)	20
Prudential Insurance Co. v. *Benjamin*, 328 U.S. 408 (1946)	12
Public Utilities Commission v. *Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927)	12
South Dakota Public Utilities Commission v. *FERC*, 690 F.2d 674 (8th Cir. 1982)	18, 19
Stoll v. *Gottleib*, 305 U.S. 165 (1938)	11
Violet v. *FERC*, 800 F.2d 280 (1st Cir. 1986)	18, 19
Washington v. *Davis*, 426 U.S. 229 (1976)	17
Administrative Decisions:	
Arizona Public Service Company, 23 FERC ¶ 61,419 (1983), *summarily affirming*, 21 FERC ¶ 63,007 (1982)	18
Arizona Public Service Company, 27 FERC ¶ 61,185 (1984)	18
Boston Edison Co., 46 P.U.R. 4th 431, 471 (Mass. DPU, 1982)	19
Middle South Energy, Inc., 26 FERC ¶ 63,044 (1984)	4, 6
Middle South Energy, Inc., 31 FERC ¶ 61,305 (1985)	4, 6
Minnesota Power & Light Co., 11 FERC ¶ 61,312 (1980)	17, 18
New England Power Co., 8 FERC ¶ 61,054 (1979), *aff'd sub nom.*, *NEPCO Municipal Rate Committee* v. *FERC*, 668 F.2d 1327 (D.C. Cir. 1981)	18

	Page(s):
New England Power Co., 31 FERC ¶ 61,047 (1985), *aff'd*, 800 F.2d 280 (1st Cir. 1986)	15
New England Power Co., 32 FERC ¶ 61,112 (1985), *aff'd sub nom.*, *Violet* v. *FERC*, 800 F.2d 280 (1st Cir. 1986)	18, 19
New England Power Co., 42 FERC ¶ 61,016 (1988)	18
Northern States Power Co., 17 FERC ¶ 61,196 (1981), *aff'd sub nom.*, *South Dakota Public Utilities Commission* v. *FERC*, 690 F.2d 674 (8th Cir. 1982)	18
Southern California Edison Co., 8 FERC ¶ 61,198 (1979), *aff'd sub nom.*, *Anaheim, Riverside* v. *FERC*, 669 F.2d 799 (D.C. Cir. 1981)	18
System Energy Resources, Inc. 41 FERC ¶ 61,238 (1987)	7
Union Electric Co., 40 FERC ¶ 61,046 (1987)	18
Statutes:	
28 U.S.C. § 1254(1)	1
Federal Power Act, 16 U.S.C. §§ 791a-828c	
Section 205	13
Section 206	13
Section 306	13
Miscellaneous:	
Brief Of Council Of City Of New Orleans As Amicus Curiae, *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970 (filed January 22, 1988)	15

	Page(s):
Brief for FERC as Amicus Curiae, *NOPSI* v. *City of New Orleans*, 782 F.2d 1236 (5th Cir. 1986)	22
Brief for the United States and the FERC as Amici Curiae, *American Electric Power Co.* v. *Kentucky Public Service Comm'n*, 481 U.S. 1023 (1987) ...	22
Brief for the United States and the FERC as Amici Curiae, *NOPSI* v. *Council of New Orleans*, 109 S. Ct. 2506 (1989) (on petition for writ of certiorari)	22
Brief for the United States and the FERC as Amici Curiae, *NOPSI* v. *Council of New Orleans*, 109 S. Ct. 2506 (1989)	22
Degnan, *Federalized Res Judicata*, 85 Yale L.J. 741, 744 (1976)	11
Regulation of Electricity Sales-For-Resale and Transmission Service, FERC Statutes and Regulation, ¶ 35,519 (1985)	18
18 C. Wright, A. Miller & E. Cooper, *Federal Practice and Procedure*, § 4468 (1981)	11

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OCTOBER TERM, 1990

NEW ORLEANS PUBLIC SERVICE INC.,

Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

New Orleans Public Service Inc. ("NOPSI") respectfully submits this petition for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit (Appendix ("App.") 1A-24A) is reported at 911 F.2d 993. The opinion of the District Court (App. 25A-32A) is unreported.

JURISDICTION

The opinion and judgment of the Court of Appeals were entered on August 29, 1990. App. 2A. On October 17, 1990, the Court of Appeals denied petitioner's timely petition for rehearing by the panel. App. 34A. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1). *See Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 460 U.S. 1 (1983).

CONSTITUTIONAL AND STATUTORY PROVISIONS

The pertinent provisions of the Federal Constitution and the Federal Power Act, 16 U.S.C. §§ 791a-828c, are reprinted at App. 35A-46A.

STATEMENT OF THE CASE

This case presents the same question that was decided in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), and in *Mississippi Power & Light Co.* v. *Mississippi ex rel Moore* ("*MP&L*"), 487 U.S. 354 (1988): whether a state or municipality may use its retail ratemaking authority to nullify a FERC decision that allocates the wholesale costs of generating electricity among affiliated utilities that serve different states. Indeed, this case involves a retail ratemaking order that does precisely what was held *per se* unlawful in *MP&L*: it has "prevented NOPSI from recovering" (App. 2A)—and "trapped"—over $135 million of the very FERC-mandated costs that were at issue in *MP&L*. 487 U.S. at 372.

However, the Fifth Circuit has held that the Council's Order is not "facially preempted" under *MP&L*. It concluded that this Court's "prior preemption decisions" establish only that FERC has exclusive jurisdiction over a multi-state system's *initial* decision to build a generating plant, and the Fifth Circuit held that the states retain jurisdiction to determine whether one of the affiliated utilities behaved "imprudently" while construction of the wholesale plant was "underway." App. 15A-18A. Under this holding, states may bar the recovery of wholesale costs that FERC found to be "just and reasonable" and ordered the utility to incur whenever a state finds that the utility was imprudent in failing to take greater steps to "minimize its losses" during construction of a power plant. App. 16A-18A.

This holding squarely conflicts with *MP&L* and *Nantahala*. Further, even if the Fifth Circuit were correct that this case is not controlled by this Court's "prior preemption decisions," the Fifth

Circuit's holding conflicts with decisions of the supreme courts of Massachusetts, Minnesota, and North Dakota[1] and with numerous FERC and court of appeals decisions that recognize the jurisdiction that the Fifth Circuit has denied FERC.[2] Each decision recognizes that it would destroy the Congressional scheme if FERC lacked jurisdiction to make these prudence determinations and if states or municipalities could bar recovery of the FERC-allocated costs on such grounds.

For this reason, FERC has argued, in four separate *amicus curiae* briefs in this case, that the Council's Order subverts FERC's regulation of interstate commerce and is preempted. *See* pp. 21-22, *infra*.

1. The MSU System And Grand Gulf. This case arises from the same facts and same FERC orders that were at issue in *MP&L*. Because this Court also discussed the Council's Order in its earlier abstention holding in this case (*NOPSI* v. *Council of New Orleans*, 109 S. Ct. 2506 (1989)), the facts that give rise to this case can be set forth briefly.

Petitioner NOPSI provides electric service in the City of New Orleans. Like MP&L, NOPSI is a wholly-owned subsidiary of Entergy Corporation (formerly named Middle South Utilities, Inc. ("MSU")) and is a part of the MSU System. The MSU System also includes two other operating electric utility subsidiaries (Arkansas Power & Light Company and Louisiana Power & Light Company), and System Energy Resources, Inc. (formerly Middle South Energy, Inc.) ("MSE"), which is a separate wholesale generating subsidiary that owns the MSU System's 90% interest in Grand Gulf 1.

As this Court stated, the four MSU operating companies "operate as an integrated power pool" (*MP&L*, 487 U.S. at 357), in

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[1] *Eastern Edison Co.* v. *Department of Public Utilities*, 446 N.E. 2d 684 (Mass. 1983); *Northern States Power Co.* v. *Minnesota Public Utilities Comm'n*, 344 N.W.2d 374 (Minn. 1984); *Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32 (N.D. 1981).

[2] *See* pp. 17-20, *infra*.

which each MSU company "transmit[s] the electricity [it] produce[s] to a central dispatch center and . . . draws back the power it needs to meet customer demand." App. 3A-4A.

The arrangements among the MSU companies for the transmission, sale, and exchange of energy are governed by System Agreements that are filed with FERC. *MP&L*, 487 U.S. at 357. Under these binding FERC rate schedules, decisions of whether and how to add generating capacity to the MSU System—or sell off capacity—are made by a majority vote of a system-wide operating committee. Because NOPSI and the other MSU operating companies each have one representative on the committee, each company thus participates in decisions to add capacity. *See MSE*, 31 FERC ¶ 61,305, pp. 61,645-51 (1985).

In 1974, as part of a system plan to reduce its dependence on oil and gas, MSU formed MSE to finance, construct, and operate the Grand Gulf 1 nuclear plant. The available information in 1974 showed that Grand Gulf 1 would be needed to meet the growing demand in the system and would further produce enormous savings for the system as a whole.

However, it later became apparent that system-wide demand would be lower than forecast and that "regulatory delays," "additional construction requirements" resulting from the Three Mile Island accident, and high inflation would dramatically increase the cost of constructing the plant. *MP&L*, 487 U.S. at 359. Nonetheless, although the System cancelled other projects—and had previously sold off a 10% interest in Grand Gulf (*see MSE*, 31 FERC ¶ 61,305, p. 61,668 n.3 (1985))—the MSU System decided to retain its 90% interest in Grand Gulf 1 and to continue construction of it. As a FERC ALJ found, it appeared in 1980 that Grand Gulf 1 would produce "power for a total cost (capacity and energy) which would be less than existing alternatives on the system." *MSE*, 26 FERC ¶ 63,044, pp. 65,112-13 (1984); *see MP&L*, 487 U.S. at 359.

However, the costs of completion escalated between 1980 and July, 1985, when Grand Gulf 1 began commercial operations.

FERC found that these cost escalations were "unforeseeable" (*MSE*, 31 FERC ¶ 61,305, p. 61,654-55 (1985)), and FERC "approved" the finding of one of its ALJ's that the "decision to construct and complete Grand Gulf 1 was sound." App. 6A; *see MP&L*, 487 U.S. at 363.

2. The FERC Proceedings And Decisions. Grand Gulf 1 required the MSU System to adopt a new method of allocating generating costs among the MSU companies, and the MSU companies filed two new rate schedules with FERC in 1982: (1) a Unit Power Sales Agreement ("UPSA"), which establishes wholesale rates for Grand Gulf power and allocated the Grand Gulf energy and capacity among the MSU companies, and (2) a new System Agreement, which allocates other generating and transmission costs. UPSA and the 1982 System Agreement, taken together, allocate all the power available on the Middle South System.

Because the "parties . . . recognized the impact that FERC's Order would have on the jurisdiction of the state regulatory agencies" (*MP&L*, 487 U.S. at 375), the City of New Orleans and representatives of the other affected jurisdictions (Mississippi, Arkansas, and Louisiana) all participated extensively in these FERC proceedings. *See MP&L*, 487 U.S. at 361. Each argued that little or no Grand Gulf output should be allocated to its operating utility.

After three years of proceedings, FERC issued a decision establishing "just and reasonable" wholesale rates for Grand Gulf 1 power. Because FERC "implicitly" found that Grand Gulf 1 had been "prudent[ly]" planned, constructed, and completed to meet the needs of the MSU System as a whole (*MP&L*, 487 U.S. at 363), FERC allowed MSE to "recoup 100% of the costs of Grand Gulf in the wholesale rates it charged to the four operating companies." *MP&L*, 487 U.S. at 375.

FERC further found that the reasonable costs of Grand Gulf should be allocated among the MSU companies on whose behalf

the plant was built and that the establishment of "just, reasonable, and non-discriminatory" rates required that the MSU operating companies "share the cost of the system's investment in nuclear energy in proportion to their relative demand for energy generated by the system as a whole." *MP&L*, 487 U.S. at 364. To achieve this allocation, FERC dramatically changed the entitlement percentages of UPSA, as follows:

	UPSA, as filed	Allocation under Opinion No. 234
AP&L	0%	36%
LP&L	38.57%	14%
MP&L	31.63%	33%
NOPSI	29.80%	17%

In adopting this cost allocation method, FERC rejected arguments of Mississippi and Arkansas representatives.[3] In addition, FERC explicitly rejected New Orleans' arguments that NOPSI should be allocated only 9% of the costs of Grand Gulf 1 and proportionately greater amounts of the MSU System's lower-cost coal power.[4]

[3]Specifically, FERC rejected their claims that Grand Gulf 1 allocations should be based on (1) "local conditions" and the "needs" of individual companies (*see MP&L*, 487 U.S. at 364 & 376), (2) representations of operating company officials to state or local officials (*see MP&L*, 487 U.S. at 376 n.14), or (3) the private contractual allocations. *See MSE*, 31 FERC at 61,655; *MSE*, 32 FERC at 61,961; *see also MP&L*, 487 U.S. at 363-64. For example, FERC rejected Arkansas's and AP&L's arguments that a 0% allocation was appropriate because AP&L had itself acquired sufficient coal and nuclear capacity to meet its own needs and had contracted away its share of Grand Gulf 1 to the other MSU companies. 32 FERC at 61,958; 26 FERC at 65,119.

[4]New Orleans urged that FERC should achieve these results by revising the 1982 System Agreement to require "production cost equalization" and give all four MSU operating companies the benefits of the system's mix of high-cost and low-cost power. *MSE*, 31 FERC at 61,641-42; *MSE*, 30 FERC at 65,141. Alternatively, New Orleans claimed NOPSI's share of the higher-cost Grand Gulf capacity allocation should not, in any event, be more than 9% because that is its percentage of the System's peak demand. *See MSE*, 31 FERC at 61,642.

New Orleans reiterated its challenges to the FERC allocation in the initial appeals of the FERC orders (*see Mississippi Industries* v. *FERC*, 808 F.2d 1525 & 822 F.2d 1103 (D.C. Cir. 1987)), in subsequent remand proceedings before FERC (*see SERI*, 41 FERC ¶ 61,238 (1987)), and in appeals from the subsequent FERC Opinions that reaffirmed the allocations. *See City of New Orleans* v. *FERC*, 875 F.2d 903 (D.C. Cir. 1989), *cert. denied*, 110 S. Ct. 1805 (1990). Each tribunal rejected these claims.

3. The Council's Prudence Investigation And Order. After Grand Gulf began operations in July of 1985, the Council initiated a prudence investigation "for the purpose of determining what portion, if any, of NOPSI's Grand Gulf 1 expenses should be assumed by shareholders, rather than being passed through to its retail ratepayers." Resolution No. R-85-636. On February 4, 1988, the Council entered an order that disallows $135 million of NOPSI's FERC-mandated Grand Gulf costs and that would produce a total loss to NOPSI of approximately $300 million (including carrying costs).

As this Court has recognized (*NOPSI*, 109 S. Ct. at 2517), the basis for this disallowance is the Council's finding that, if NOPSI had been prudent, it would, in 1980, have sold "that portion of [its Grand Gulf] commitment which exceeded a 9 percent share of Grand Gulf" and replaced it by buying equivalent amounts of coal-fired capacity at hypothetically lower rates. *See* Council Order, p. 12. This would have achieved the precise result that the City had unsuccessfully urged in the FERC proceedings. *See* p. 6 & n. 4, *supra*.

The Council's disallowance order rests on four subsidiary findings. Each finding is inconsistent with FERC's explicit determinations.[5]

[5]First, the Council found that it should have been apparent in 1980 that Grand Gulf 1 power would be so much more expensive than coal-fired power that NOPSI should have sold off its then-contingent interest

(footnote continued on next page)

4. This Case. On February 9, 1988, NOPSI filed this action in federal district court to enjoin the Council's order. The District Court abstained—in a decision affirmed by the Fifth Circuit—on the ground that NOPSI's federal, as well as state law, claims could be pursued only in a parallel state court proceeding.

This Court subsequently reversed the Fifth Circuit's abstention holding. It identified two federal claims that could be maintained in federal court on remand: (1) that the Council's retail rate order

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(footnote continued from previous page)
in the plant. Council Order, pp. 11-12 & 131-32. By contrast, FERC approved NOPSI's and the MSU System's 1980 decision to complete Grand Gulf 1 (and retain their 90% interest) because it then appeared Grand Gulf would be cheaper than available alternatives and was a reasonable fuel diversification measure. *MP&L*, 487 U.S. at 363; *see* pp. 4-5, *supra*.

Second, the Council found that NOPSI's "system responsibility" for Grand Gulf is the 9% that the Council unsuccessfully urged before FERC. Council Order, pp. 11-12. By contrast, FERC found that establishment of nondiscriminatory rates and cost allocations required that NOPSI bear 17% of the costs of Grand Gulf. *See* p. 6, *supra*; App. 5A-6A n.3.

Third, the Council found NOPSI could have embarked on a fuel diversification strategy of its own "in light of local interests" if it believed the MSU System plan was not in the best interests of New Orleans. Council Order, pp. 10-11 & 119-26. By contrast, FERC found that the MSU System made the decision to complete Grand Gulf to benefit "the System as a whole." Indeed, the FERC rate schedules require system-wide decisionmaking and prohibit individual MSU companies from nullifying the system plan by unilaterally acquiring or selling off capacity. *See* pp. 3-4, *supra*.

Fourth, the Council found that NOPSI would have reduced its generation costs if it had sold off 8% of the Grand Gulf allocation in 1980 and bought equivalent amounts of coal-fired capacity at hypothetically lower rates. Council Order, p. 12. By contrast, FERC found in 1985 that the same conduct by AP&L in the late 1970's could *not* reduce either its Grand Gulf allocation or its generating costs. *See* p. 6 n.3, *supra*. Similarly, FERC's allocation method would have precluded NOPSI from realizing more than negligible savings, if any, if NOPSI could have pursued the "sell-off option" in 1980.

Further, as the District Court previously emphasized, the Council has also not identified a single "sucker" utility that would or could have prudently bought NOPSI's Grand Gulf capacity in 1980 under the Council's findings. *See NOPSI*, 109 S. Ct. at 2512 n.2.

is "facially preempted" by FERC's orders under the Federal Power Act (*NOPSI*, 109 S. Ct. at 2514-15), and (2) that the Council's disallowance was a "pretext" and a "cover" for a challenge to the original Grand Gulf allocation. *NOPSI*, 109 S. Ct. at 2515.

On remand, NOPSI filed a motion for summary judgment that raised each of these claims. However, following a trial court decision for the Council in the parallel state case, the District Court entered an order that rejected NOPSI's facial preemption claim on the merits (*see* App. 26A-27A) and that stayed litigation of the "pretextual" preemption claim. *See* App. 27A-32A.

5. The Fifth Circuit's Decision. The Fifth Circuit affirmed each of these holdings. First, while it recognized that "[t]he Council's order prevented NOPSI from recovering, in retail rates, wholesale costs FERC ordered it to incur as a result of its participation in [Grand Gulf 1]" (App. 2A), the Fifth Circuit held that the Council's Order is not "facially preempted" by the Orders that FERC had validly entered under the Federal Power Act. App. 15A-18A.

The Fifth Circuit recognized that *MP&L* holds that, if FERC had jurisdiction to make a determination, then "the states cannot have jurisdiction over it." App. 16A.[6] However, the Fifth Circuit concluded that this Court's "prior preemption decisions" "established" only that "FERC has jurisdiction to determine whether the [NOPSI and the other MSU] utilities acted prudently in deciding to participate in the Grand Gulf venture" initially and that *MP&L*, *Nantahala*, and other such decisions had not addressed FERC's jurisdiction to determine prudence "once the Grand Gulf project was underway." App. 16A.

In deciding this question, the Fifth Circuit stated that it is "plain" that FERC has not "assert[ed] jurisdiction" to determine

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[6]The Fifth Circuit further recognized that, under *MP&L*, the fact that FERC had ordered the specific purchases foreclosed the Council's claim that it was imprudent for NOPSI to resell large quantities of Grand Gulf 1 power to its retail customers. App. 15A.

a utility's prudence during construction of a wholesale generating plant and that the Fifth Circuit had to "assume" that FERC lacks this jurisdiction. App. 16A-17A. Otherwise, FERC could preempt the states from exercising what the Fifth Circuit regarded as their "traditional" regulatory authority and could achieve "the result Justice Brennan feared" in his dissenting opinion in *MP&L*. App. 17A. Because the Fifth Circuit concluded that Congress had not expressed a "clear and manifest" purpose to confer this jurisdiction upon FERC, the Fifth Circuit held that it is the states, and not FERC, that have the jurisdiction to determine the "prudence" of a utility's "failure" to "minimize its losses" by "diversify[ing] its supply portfolio" during construction of a system plant. App. 15A & 16A. The Fifth Circuit believed that this view was supported by this Court's earlier *abstention* holding in this case. App. 17A.[7]

Second, the Fifth Circuit also upheld the District Court's decision to stay the "pretextual" preemption claim on the ground that it does not present a "substantial federal question." The Fifth Circuit held that a court may not consider the Council's motives in addressing the pretext claim that this Court identified, but may do no more than determine the sufficiency of the evidence to support the Council's findings under state law. App. 20A-22A.

Finally, unless it is reversed, the Fifth Circuit decision will be a final rejection of NOPSI's federal preemption claims. Although a parallel state case is now pending in the intermediate appellate court of Louisiana, the Fifth Circuit decision will preclude litigation of the "facial" federal preemption claims in the parallel state court proceedings and will further preclude any claim based on

[7]In this regard, although the Fifth Circuit stated that "[i]t is plain" that the Court's earlier decision in this case only addressed abstention and "did not hold the facial preemption claim was foreclosed" (App. 10A), the Fifth Circuit stated that "we are convinced that the [Supreme] Court in *NOPSI III* did not believe the Council could not regulate NOPSI's activities in this regard." App. 17A.

the Council's motive.[8] Accordingly, the pending state court appeals from the Council's order have been limited to the question whether the Council's order violates state law.

REASONS FOR GRANTING THE PETITION

In this case, the Fifth Circuit has established an exception to FERC's jurisdiction under the Federal Power Act that would swallow the rule. Although the Fifth Circuit recognized FERC's exclusive jurisdiction over some elements of wholesale rates, it held that FERC does not have jurisdiction to determine whether a utility was imprudent in failing to take greater steps to "minimize" its risks during construction of a wholesale power plant. App. 15A-18A. Under this holding, each state served by a multistate utility system may do what this Court held to be preempted in *MP&L* and *Nantahala*—effectively relitigate FERC-approved rates and allocations and "trap" FERC-mandated costs —subject only to state court sufficiency of evidence review. *MP&L*, 487 U.S. at 272. This would totally subvert Congress's purpose of centralizing all such determinations in a single neutral federal forum: FERC.

The Fifth Circuit's decision squarely conflicts with *MP&L*, *Nantahala*, and their precursors—such that the Fifth Circuit's decision could be summarily reversed without burdening this Court's docket. *Compare Palmer* v. *BRG of Georgia, Inc.*, 111 S. Ct. 401 (1990). Further, even if the Fifth Circuit were correct that this Court's "prior preemption decisions" do not foreclose the Council's Order (App. 17A), the Fifth Circuit's decision conflicts with the decisions of the Massachusetts, Minnesota, and North

[8]*See Stoll* v. *Gottleib*, 305 U.S. 165, 170 (1938) (state court must give *res judicata* and collateral estoppel effect to federal court's determinations); *Embry* v. *Palmer*, 107 U.S. 3 (1882) (same); Degnan, *Federalized Res Judicata*, 85 Yale L.J. 741, 744 (1976) (same); 18 C. Wright, A. Miller & E. Cooper, *Federal Practice and Procedure*, § 4468 (1981) (same).

Dakota Supreme Courts and with the decisions of FERC and the First, Eighth, and District of Columbia Circuits that have upheld the jurisdiction that the Fifth Circuit has denied FERC.

In this regard, this case involves far more than the departures from settled preemption principles that led this Court to review the lower courts' decisions in *Nantahala* and *MP&L*. By denying FERC jurisdiction to determine utility prudence during construction of a wholesale generating facility, the Fifth Circuit has both foreclosed FERC from making determinations essential to ratemaking and has authorized state nullification of FERC's interstate cost allocations.

I. The Fifth Circuit's Decision Conflicts With *MP&L*, *Nantahala*, And Other Decisions Of This Court.

Congress enacted the Federal Power Act because it recognized that bulk power arrangements among utilities in multistate systems are "particularly likely to affect more than one State" and that "uncontrolled [state] regulation" can "patently interfere with broader national interests." *Arkansas Elec. Coop. Corp.* v. *Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 377 (1983).[9] Congress thus established a single neutral forum to assure that wholesale rates and contracts affecting such rates are "just, reasonable, and nondiscriminatory"—with FERC to balance interests of shareholders and ratepayers in setting wholesale rates and to allocate the prudent wholesale costs among utilities serving different states. The Act protects local interests by giving states and

[9]Although it is often said that the Federal Power Act filled the "gap" created by this Court's holdings that states could not regulate such transactions (*see Public Utilities Commission* v. *Attleboro Steam & Electric Co.*, 273 U.S. 83, 89-90 (1927)), Congress could have filled the "gap" by authorizing state regulation. *Prudential Ins., Co.* v. *Benjamin*, 328 U.S. 408, 427-33 (1946). Instead, Congress codified *Attleboro*'s concerns about parochial state regulation that burdens interstate commerce by requiring exclusive federal regulation of all wholesale power transactions.

municipalities the right to participate in FERC proceedings and to urge FERC to disallow wholesale costs on the ground the utilities were imprudent in incurring some or all of them. Federal Power Act, §§ 205, 206 & 306; App. 37A-44A.

Contrary to the Fifth Circuit's holding (*compare* App. 17A-18A), this Court has construed the Act to give FERC "plenary jurisdiction" to make all determinations required to regulate wholesale rates and to allocate costs among affiliated utilities, regardless of the "impact" on state regulation. *See FPC* v. *Southern California Edison Co.*, 376 U.S. 205, 215-16 (1964). Similarly, this Court developed the "filed rate doctrine" and other preemption principles to "enforce the exclusive jurisdiction vested by Congress in FERC." *Nantahala*, 476 U.S. at 966. Decades of decisions by this Court establish that, regardless of how state action is labeled, it is preempted if its "effect" is to interfere with FERC interstate "allocation of costs" (*Maryland* v. *Louisiana*, 451 U.S. 725, 749-50 (1981)) or to impose sanctions on conduct that FERC has jurisdiction to "declare unjust and unreasonable."[10] *See Chicago & N.W. Transp. Co.* v. *Kalo Brick & Tile Co.*, 450 U.S. 311, 324-27 (1981).

Thus, the only way the Fifth Circuit could uphold the Council's Order is by holding that FERC lacks jurisdiction over the Council's claims that NOPSI was imprudent. Accordingly, the Fifth Circuit rested its decision on the ground that *MP&L*,

[10]On this basis, states have been held to be preempted from applying their tax laws, contract remedies, tort laws, and anti-fraud provisions as well as their utility laws in ways that have the effect of intruding, directly or indirectly, on federal authority. *Northern Natural Gas Co.* v. *State Corp. Comm'n of Kansas*, 372 U.S. 84, 91-92 (1963) (state utility laws); *Maryland* v. *Louisiana*, 451 U.S. 725 (1981) (state tax laws); *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571 (1981) (state contract remedies); *Chicago & N.W. Transp. Co.* v. *Kalo Brick & Tile Co.*, 450 U.S. 311 (1981) (state tort laws); *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246 (1951) (state anti-fraud provisions); *Schneidewind* v. *ANR Pipeline Co.*, 485 U.S. 293 (1988) (state utility laws).

Nantahala, and this Court's other prior decisions do not establish FERC's exclusive jurisdiction to determine whether MSU, MSE, or the individual MSU operating companies acted prudently in failing to take greater steps to "minimize their losses" while construction of the Grand Gulf 1 plant was "underway." App. 16A-18A. However, that is precisely what *MP&L* established.

In *MP&L*, the Court reviewed a judgment of the Mississippi Supreme Court that did not question the prudence of the initial 1974 decision to build Grand Gulf 1. *Compare* 16A. Rather, the Mississippi court stated that it had become "obvious" by "the early 1980's, that both the cost and demand projections related to Grand Gulf were terribly incorrect," and the Mississippi Supreme Court ordered a prudence "review" to determine whether "MP&L, MSEI, and MSU acted reasonably when they constructed Grand Gulf 1, in light of the change in demand for electric power . . . and the sudden escalation of costs." *Mississippi ex rel. Pittman* v. *Mississippi Public Service Commission*, 506 So.2d 978, 986, 987 (1987); *see MP&L*, 487 U.S. at 368.

Had this prudence investigation proceeded, it would have addressed whether MP&L or the other MSU companies had been imprudent in the early 1980's by failing to recognize the magnitude of the risks created by Three Mile Island and to minimize their losses by cancelling or selling Grand Gulf 1, by relying on alternative power sources, or by otherwise reducing their economic commitments. The Mississippi commission would then have decided the extent to which the Grand Gulf costs should be "trapped" and borne by the utility's shareholders, rather than "passed on to MP&L's retail customers." *MP&L*, 487 U.S. at 372 n.12.

MP&L reaffirmed the Court's earlier decision in *Nantahala* and held that the Federal Power Act and the Supremacy Clause "preclude [such a] review of MP&L's managerial prudence." 487 U.S. at 369. It held that a state retail ratemaking body "may not enter an order 'trapping' the costs MP&L [and other MSU operating companies are] mandated to pay under the FERC order allocating Grand Gulf power or undertake a 'prudence' review for the purpose of deciding whether to enter such an order." *MP&L*, 487 U.S. at 372 & n.12; *see also Nantahala*, 476 U.S. at 970. This is precisely what the Council did here. *See* p. 7, *supra*.[11]

In so holding, the Court made it explicit that, contrary to the Fifth Circuit's holding, FERC has exclusive jurisdiction to determine the prudence of MP&L and the other MSU operating companies in failing to minimize their risks in the aftermath of the Three Mile Island accident. The Court stated that all such "prudence" claims were matters "FERC easily could have considered in determining whether to permit MSE to recoup 100% of the costs of Grand Gulf in the wholesale rates it charged to the four operating companies and in allocating Grand Gulf power" among those companies. *MP&L*, 487 U.S. at 375.[12] In this regard, the Court recognized that to the extent FERC did not address the prudence of the MSU companies, it was because New Orleans and the state parties "failed to raise the matter," not because FERC has not "asserted" this jurisdiction.[13]

Indeed, this is a far clearer case for preemption than was *MP&L*, for the Council's Order does more than bar recovery of FERC-mandated wholesale costs on grounds that "could have

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[11]Because the Council was then conducting the same kind of prudence investigation that the Mississippi Supreme Court had ordered, the Council filed *amicus curiae* briefs in *MP&L* that argued that at least some state investigations of the prudence of the Grand Gulf 1 expenses of MSU operating companies are not preempted by the Federal Power Act and that the Court should allow the Mississippi prudence investigation to proceed. Brief Of Council Of City Of New Orleans As Amicus Curiae, *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970, p.10 (filed January 22, 1988). The Court rejected this claim. *MP&L*, 487 U.S. at 372 & n.12.

[12]Indeed, the Court cited FERC opinions in which it decided state claims that a utility had been imprudent in failing to take certain steps to minimize its risks during construction of a nuclear plant. *Id., citing New England Power Co.*, 31 FERC ¶ 61,047, pp. 61,081-61,084 (1985), *aff'd*, 800 F.2d 280 (1st Cir. 1986).

[13]*Compare* 487 U.S. at 375 & 379-80 n.* (Scalia, J.) (quoting colloquy with counsel for New Orleans), *with* App. 15A-16A.

been raised" before FERC.[14] The Council's prudence disallowance rests on findings that are foreclosed by FERC's explicit determinations (*see* pp. 7-8 n.5, *supra*), so the Council has collaterally attacked FERC's findings. Indeed, what the Council found to have been imprudent was NOPSI's failure to anticipate in 1980, and to seek to avoid, the very cost allocation that FERC subsequently determined to be "just and reasonable" in its 1985 orders.

Finally, the Fifth Circuit also relied on this Court's earlier abstention decision in this case and on the Fifth Circuit's conviction that "the [Supreme] Court in *NOPSI III* did not believe that the Council could not regulate NOPSI's activities" in the way it did. App. 17A. This statement is inexplicable. As the Fifth Circuit also stated, "[i]t is plain, however, that the [Supreme] Court held *only* that the [Council's] order was not 'flagrantly' unlawful for *Younger* abstention purposes; it did not hold the facial preemption claim was foreclosed." App. 10A (emphasis added). Indeed, if this Court's earlier abstention decision in this case had barred NOPSI's facial preemption claim, it would have overruled, *sub silentio*, *MP&L*, *Nantahala*, and decades of prior preemption decisions. *See* pp. 12-13 & n.10, *supra*.

But the fact that the Fifth Circuit has so misread this Court's abstention decision—and further held that the state law substantial evidence requirements are the only limitations on state subversion of FERC regulation[15]—makes review of this decision a matter of compelling importance.

[14]Similarly, the Fifth Circuit is simply wrong that its holding is "analogous" to the principle that increases in FERC-regulated wholesale rates need not invariably lead to dollar-for-dollar increases in retail rates. App. 17A-18A. The reason for this rule is that a utility can experience offsetting "cost savings in other areas" that FERC does not regulate. *See Nantahala*, 476 U.S. at 968. By contrast, here the Council did what *MP&L* and *Nantahala* prohibit: it barred recovery of the costs that FERC not only regulates, but found just and reasonable.

[15]In this regard, even if the Council's Order were not "facially preempted" under *MP&L*, the Fifth Circuit is wrong that the Order is not

(footnote continued on next page)

II. The Fifth Circuit's Decision Conflicts With Decisions Of The Massachusetts, Minnesota, And North Dakota Supreme Courts And With The Decisions Of FERC And Several Federal Courts Of Appeals.

Second, even if the Fifth Circuit were correct that this case is not controlled by the Court's "prior preemption decisions," the Fifth Circuit's decision conflicts with the decisions of the Massachusetts, Minnesota, and North Dakota Supreme Courts and with numerous FERC and federal courts of appeals decisions. They recognize that FERC has exclusive jurisdiction to determine the prudence of a utility's failure "to minimize its losses" during construction of a wholesale generating plant and to decide the extent to which shareholders rather than ratepayers should bear some, or all, of the costs of the plant.

FERC routinely exercises this jurisdiction in cases involving generating facilities of interstate electric systems that were either cancelled before completion or completed and operated. When a prudence claim is raised,[16] FERC determines whether the utilities were imprudent in failing to recognize the risks created by an event like the Three Mile Island accident and to minimize their

(footnote continued from previous page)
invalidated by the Council's clear intent collaterally to attack the 17% Grand Gulf allocation. This Court has rejected the Fifth Circuit's reading of *Palmer* v. *Thompson*, 403 U.S. 217 (1971), and has held that such illicit motives invalidate otherwise lawful state action. *Compare Washington* v. *Davis*, 426 U.S. 229, 244 n.11 (1976) & *Hunter* v. *Underwood*, 471 U.S. 222, 231-33 (1985) *with* App. 21A-22A. This rule is fully applicable to federal preemption. *See, e.g., English* v. *General Electric Co.*, 110 S. Ct. 2270, 2278 (1990) (improper "motivation behind the state law" establishes preemption); *Pacific Gas & Elec. Co.* v. *State Energy Resources Conservation and Development Comm'n*, 461 U.S. 190, 214-16 (1983) (state action preempted if it was concerned "with the economics of nuclear power," rather than safety).

[16]Under FERC's practice, an investment is presumed to be prudent unless a party raises prudence objections or a serious doubt about the prudence of an investment is otherwise raised. *See, e.g., Minnesota Power & Light Co.*, 11 FERC ¶ 61,312, p. 61,645 (1980).

losses by (1) cancelling the plant at an earlier point in time, (2) selling, or otherwise reducing, their economic interest in the plant, (3) diversifying their power sources by pursuing alternatives to the nuclear plant, or (4) taking other action during construction.[17] Indeed, FERC exercises jurisdiction to review the "prudence of [a utility system's] action in keeping, rather than selling, a [nuclear] plant" even prior to the time the utility seeks to recover those costs under FERC rate schedules.[18]

The Courts of Appeals for the First, Eighth, and District of Columbia Circuits have each upheld FERC's jurisdiction to make these prudence determinations.[19] In turn, at least three state supreme courts have explicitly held that FERC's jurisdiction pre-

[17]*See New England Power Co.*, 8 FERC ¶ 61,054 (1979) (permitting utilities to recover all costs *prudently incurred* prior to cancellation of oil-fired plant and allocating loss between ratepayers and shareholders), *aff'd sub nom., NEPCO Municipal Rate Committee* v. *FERC*, 668 F.2d 1327 (D.C. Cir. 1981); *Southern California Edison Co.*, 8 FERC ¶ 61,198 (1979) (disallowing costs of abandoned plant on ground of imprudence during construction), *aff'd sub nom., Anaheim, Riverside* v. *FERC*, 669 F.2d 799 (D.C. Cir. 1981); *Minnesota Power & Light Co.*, 11 FERC ¶ 61,312 (1980) (same); *Northern States Power Co.*, 17 FERC ¶ 61,196 (1981) (determining amount of prudently-incurred costs and rejecting prudence challenge to cancellation of Tyrone nuclear plant), *aff'd sub nom., South Dakota Public Utilities Comm'n* v. *FERC*, 690 F.2d 674 (8th Cir. 1982); *New England Power Co.*, 32 FERC ¶ 61,112 (1985) (rejecting claims it was imprudent to fail to minimize losses by ending investment in cancelled Pilgrim II plant earlier), *aff'd sub nom., Violet* v. *FERC*, 800 F.2d 280 (1st Cir. 1986); *Union Electric Co.*, 40 FERC ¶ 61,046 (1987) (disallowing costs incurred during construction on grounds of imprudence); *New England Power Co.*, 42 FERC ¶ 61,016 (1988) (recovery of prudent costs of Seabrook nuclear plant). *See also Regulation of Electricity Sales-For-Resale and Transmission Service*, FERC Statutes and Regulation, ¶ 35,519 (1985).

[18]*Arizona Public Service Company*, 27 FERC ¶ 61,185, p. 61,350 (1984); *Arizona Public Service Company*, 23 FERC ¶ 61, 419 (1983), *summarily affirming*, 21 FERC ¶ 63,007 (1982).

[19]*Violet* v. *FERC*, 800 F.2d 280 (1st Cir. 1986); *South Dakota Public Utilities Comm'n* v. *FERC*, 690 F.2d 674 (8th Cir. 1982); *Anaheim, Riverside* v. *FERC*, 669 F.2d 799 (D.C. Cir. 1981). *See Minnesota* v. *FERC*, 734 F.2d 1286 (8th Cir. 1984).

empts states from disallowing FERC-mandated costs on such grounds.

For example, the Massachusetts Supreme Judicial Court so held in *Eastern Edison Company* v. *Department of Public Utilities*, 446 N.E.2d 684 (Mass. 1983). There, Eastern Edison's wholesale generating affiliate (Montoup) had filed a FERC rate schedule that required Eastern Edison to pay its allocated share of the costs of a nuclear plant (Pilgrim II) that was abandoned in 1982, after construction was underway. The Massachusetts utility commission then refused to allow recovery of some of these FERC-mandated costs on the ground that a prudent utility would have minimized its losses by ceasing investment in Pilgrim II on July 1, 1980, and by pursuing alternatives to this nuclear capacity on that date. 446 N.E.2d at 687 n.3; *see Boston Edison Co.*, 46 P.U.R. 4th 431, 471 (Mass. DPU, 1982).

The Massachusetts Supreme Judicial Court reversed on the ground that FERC has exclusive jurisdiction to determine whether the utility system was imprudent in failing to take greater steps to minimize its risks during construction of the plant. 446 N.E.2d at 687-89. It thus held the State's exclusive remedy was to raise this prudence claim in the FERC proceedings (*id.*)—as other states did. *See New England Power Co.*, 32 FERC ¶ 61,112, pp. 61,303-61,305 (1985), *aff'd sub nom., Violet* v. *FERC*, 800 F.2d 280 (1st Cir. 1986).

This was also the holding of the North Dakota Supreme Court in *Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32, 38 (N.D. 1981). There, FERC had rejected an imprudence claim that is the reverse of the Council's claim in this case,[20] and FERC approved rate schedules that allocated costs of an abandoned nuclear plant

[20]The North Dakota, South Dakota, and Minnesota commissions had claimed in FERC proceedings that it was *imprudent* for the Northern States System to have reduced its relative nuclear commitment by cancelling the Tyrone nuclear plant and obtaining coal-fired power instead. *See South Dakota Public Utilities Commission* v. *FERC*, 690 F.2d 674, 677 (8th Cir. 1982).

(Tyrone) among the three affiliated Northern States companies. When the North Dakota public utilities commission refused to recognize these FERC-mandated costs, the North Dakota Supreme Court reversed, holding that FERC has exclusive jurisdiction "to determine the reasonableness and prudence of the Tyrone loss" and that the state commission was limited to raising its imprudence claim by "follow[ing] the remedies available in the proceeding before FERC." 314 N.W.2d at 38.

The Minnesota Supreme Court followed these holdings when the Minnesota utilities commission also barred recovery of the FERC-mandated Tyrone expenses in retail rates. *Northern States Power Co.* v. *Minnesota Public Utilities Commission,* 344 N.W.2d 374 (1984). The Minnesota Supreme Court held that "the state utilities commission is required to treat the [FERC-]allocated abandonment costs as expenses for power purchases in determining the retail rates" and may not examine the prudence of the Northern States' companies in failing to minimize those costs, or otherwise. 344 N.W.2d at 381-82 & n.17. The Minnesota Court held that these issues fall within FERC's exclusive jurisdiction (*id.*)—as has each other comparable post-*Nantahala* and post-*MP&L* decision.[21]

[21]These decisions all recognize that when FERC exercises its jurisdiction to allocate wholesale costs among affiliated utilities in integrated systems—or otherwise to mandate costs—these determinations bind states in setting retail rates. *Kentucky Power Co.* v. *Kentucky Public Service Comm'n,* No. 86-CA-1031-MR (Kentucky Court of Appeals, June 2, 1988); *Kentucky West Virginia Gas Co.* v. *Pennsylvania Public Utility Comm'n* 862 F.2d 69, 74 (3d Cir. 1988) (state commission must allow utility to pass through FERC-mandated minimum bill liability to retail customers). Thus, the only circumstances in which lower courts have permitted states to bar recovery of expenses incurred under FERC rate schedules is where FERC regulation has *not* allocated the costs to a particular utility, but has given the utility a choice to obtain the power from one of many sources. *See, e.g., Kentucky West Virginia Gas Co.* v. *Pennsylvania Public Utility Comm'n,* 837 F.2d 600 (3d Cir. 1988); *Pike County Light & Power Co.* v. *Pennsylvania Public Utility Comm'n,* 465 A.2d 735 (Penn. Commwlth Ct. 1983). As the Fifth Circuit held, that was not the case here, and the "*Pike County* line of cases" is inapposite here. App. 15A.

III. Resolution Of This Conflict Is A Matter Of Great National Importance.

Resolution of these conflicts is a matter of great national importance. As FERC's prior filings demonstrate, this case presents, if anything, a far more compelling case for Supreme Court review than did the lower courts' decisions in *Nantahala* and *MP&L*.

This case is like *MP&L* and *Nantahala* in that here, as in those cases, the lower court has established an exception to well-settled principles that would subvert the orderly scheme that Congress has created. Under this exception, each FERC wholesale rate determination could be relitigated in each state served by a multistate utility system, and states could interpose "local" parochial interests to preclude the integrated, multistate planning that the Federal Power Act allows. *See Appeal of Sinclair Machine Products, Inc.,* 498 A.2d 696, 702 (N.H. 1985). A state can always claim that a utility should have minimized its losses by cancelling a plant, by selling off high-cost power, or by purchasing lower-cost power—all to satisfy a utility's obligations to "local ratepayers."

However, the Fifth Circuit's decision threatens far greater interference with FERC regulation than did the lower court decisions in *Nantahala* or *MP&L*. Those cases did not question FERC's authority to determine the prudence of utility decision-making during the construction of a plant. *Compare MP&L,* 487 U.S. at 391 (Brennan, J., dissenting). Here, by contrast, the Fifth Circuit held that FERC is without jurisdiction to determine all prudence issues required to establish "just and reasonable" wholesale rates.

Accordingly, FERC has argued, in four separate *amicus curiae* filings in this controversy, that the Council's prudence investiga-

tion and order "frustrate the purposes of FERC's regulation and are preempted."[22]

Finally, here, as in *MP&L*, the existence of pending state proceedings presents no reason to refuse to decide the federal preemption issues. *See MP&L*, 487 U.S. at 370 n.11. As in *MP&L*, the federal preemption issue has been finally decided (*see* pp. 10-11 & n.8, *supra*), and, unless reversed, the Fifth Circuit's decision means that the state proceedings will be confined to state administrative review of the Council's Order and further state law prudence proceedings if the Council's Order is set aside. Because the "critical federal question [is] whether federal law preempts such proceedings," and because this issue is "ripe for review," it should be decided now. *See MP&L*, 487 U.S. at 370 n.11. Indeed, there is a far more compelling case for review of the federal issue here because, unlike *MP&L*, *res judicata* principles would foreclose NOPSI from raising its federal preemption issues in a petition for certiorari from a final judgment in the state case. *See* pp. 10-11 & n.8, *supra*.

[22]Brief for FERC as Amicus Curiae at 4-9, *NOPSI* v. *City of New Orleans*, 782 F.2d 1236 (5th Cir. 1986); Brief for the United States and the FERC as Amici Curiae at 16-17, 25-27, *American Electric Power Co.* v. *Kentucky Public Service Comm'n*, 481 U.S. 1023 (1987) (urging that the petition be denied, but that the pending *NOPSI I* petition be granted); Brief for the United States and the FERC as Amici Curiae at 18 & n.17, *NOPSI* v. *Council of New Orleans*, 109 S.Ct. 2506 (1989) (on petition for writ of certiorari); Brief for the United States and the FERC as Amici Curiae at 17 & n.8, *NOPSI* v. *Council of New Orleans*, 109 S. Ct. 2506 (1989).

CONCLUSION

Because this case is squarely controlled by this Court's decisions in *MP&L* and *Nantahala*, the Fifth Circuit's decision can be summarily reversed. *See Palmer* v. *BRG of Georgia, Inc.*, 111 S. Ct. 401 (1990). Alternatively, the petition for a writ of certiorari should be granted and the case set for oral argument.

Respectfully submitted,

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Dated: January 15, 1991

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APPENDIX

COURT OF APPEALS OPINION
[AUGUST 29, 1990]

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 90-3050

NEW ORLEANS PUBLIC SERVICE, INC.,

Plaintiff-Appellant,

versus

THE COUNCIL OF THE CITY OF NEW ORLEANS, ET AL.,

Defendants-Appellees.

Appeal from the United States District Court for the Eastern District of Louisiana

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(August 29, 1990)

Before WISDOM, HIGGINBOTHAM, and DUHÉ, Circuit Judges.

PATRICK E. HIGGINBOTHAM, Circuit Judge:

New Orleans Public Service, Inc. asks us to reverse the district court's determination that the Council's retail rate order is not "facially" preempted by federal law, specifically a wholesale rate order the Federal Energy Regulatory Commission made under the Federal Power Act. The Council's order prevented NOPSI from recovering, in its retail rate, wholesale costs FERC ordered it to incur as a result of its participation in building the Grand Gulf 1 nuclear reactor in Port Gibson, Mississippi. In the alternative, NOPSI asks us to reverse the district court's decision to stay NOPSI's remaining claims in light of pending state court proceedings. The remaining claims include an allegation that the

stated reasons underlying the Council's order were a pretext for an impermissible attack on FERC's order. We affirm the district court's order, rejecting NOPSI's "facial" preemption challenge, in part because of the reading the Supreme Court gave the Council's order on a previous appeal. We further hold that the district court did not abuse its discretion in staying decision of the remaining claims, although it did not acknowledge the relevance of the Council members' motivation to NOPSI's pretext claim in making that decision. Our reading of the Court's opinion on the previous appeal compels us to conclude that the pretext claim cannot succeed in the face of a determination that the stated reasons underlying the Council's order were sufficiently supported by the evidence; and the state trial court had already determined that they were. There was thus no substantial federal issue remaining in the case, and the district court's order was not otherwise an abuse of discretion.

I.

This case has produced several judicial opinions, including three from this court. At each juncture the case was in a different posture, with different issues. This opinion is no exception. Thus, we repeat the facts for perspective.

A.

NOPSI is a producer, wholesaler, and retailer of electricity, providing its retail services to the city of New Orleans. Along with Arkansas Power and Light, Mississippi Power and Light, and Louisiana Power and Light, it is a wholly owned operating subsidiary of Middle South Utilities, Inc.[1] MSU operates an integrated "power pool" in which NOPSI and the three other power companies transmit the electricity they produce to a central

[1]Since this case began, Middle South Utilities has changed its name to Energy Corporation. The parties refer to it by the old name in the briefs, and, for convenience, we do so as well.

dispatch center, and each draws back the power it needs to meet customer demand.

Through the 1950's and into the 1960's, most of the MSU system's generating plants were fueled with oil or gas. In the late 1960's, MSU sought to meet projected increases in demand by adding coal-fired and nuclear energy powered generating plants. Originally, MSU planned for each of the power companies to construct one or more nuclear facilities. Mississippi Power and Light was charged with constructing two plants at Port Gibson, Mississippi, to be known as Grand Gulf 1 and 2. The Grand Gulf project quickly proved too burdensome for one company, however. MSU created another subsidiary, separate from the power companies, known as Middle South Energy, Inc. to finance, own, and operate the Grand Gulf plants.[2] In 1974, MSE in turn contracted with the power companies to finance the project. The companies agreed to pay for the construction of the plants in exchange for the right to their output. The estimated construction cost at that time was $1.2 billion.

As the project progressed, consumer demand for electric power proved to be much lower than MSU and the power companies had expected. At the same time, regulatory delays, enhanced construction requirements resulting from the Three Mile Island accident, and high inflation led to spiraling costs on the Grand Gulf project. As a result, MSE suspended construction of Grand Gulf 2, although it continued to build Grand Gulf 1. The cost of completing Grand Gulf 1 alone eventually exceeded $3 billion.

The power companies considered various methods to allocate the cost of Grand Gulf in light of these developments. In 1982, MSU filed a Unit Power Sales Agreement with the Federal Energy Regulatory Commission, which set out the shares of Grand

[2]Middle South Energy is now known as Systems Energy Resources, Inc. Again, the parties refer to it by the old name in the briefs and we do so as well.

Gulf 1 output each company was required to purchase in order to pay the construction costs. Arkansas Power and Light, which had finished its own nuclear plants, was not obligated to purchase any Grand Gulf power. Louisiana Power and Light, which had not finished its plant, was obligated to purchase 38.57%. Mississippi Power and Light was obligated to purchase 31.63%, and NOPSI 29.8%. MSU also filed a new System Agreement with FERC, which set forth the terms and conditions for coordinated operations and wholesale transactions among the four companies, but did not deal with the Grand Gulf costs.

FERC assigned the agreements to two separate Administrative Law Judges for the statutorily required task of determining whether they were just and reasonable. Both judges held that the failure to distribute the Grand Gulf costs among all the members rendered the agreements unduly discriminatory; ALJ Head further held that these costs should be allocated in proportion to each company's relative system demand. *Middle South Services, Inc.*, 30 F.E.R.C. ¶ 63,030, pp. 65,170–65,173 (1985) (System Agreement); *Middle South Energy, Inc.*, 26 F.E.R.C. ¶ 63,044, pp. 65,105–65,108 (1984) (Unit Power Sales Agreement) (ALJ Head). FERC consolidated the proceedings for review, and determined that an adjustment of the shares allocated in the Unit Power Sales Agreement was all that was necessary to render both agreements just and reasonable. FERC reduced NOPSI's share from 29.8% to 17%. The decrease did not satisfy the New Orleans City Council, however, which had argued for a 9% share for NOPSI.[3] The D.C. Circuit ordered FERC to reconsider the

[3]FERC found that Grand Gulf 1 had been planned, constructed, and completed to meet the needs of the MSU System "as a whole." *Mississippi Power and Light*, 108 S.Ct. at 2434; 31 FERC ¶ 61,305, pp. 61,651-57 (1985). FERC further found that this was part of a "reasonable" system plan to diversify power sources, so it established rates that would allow MSE to recoup 100% of the Grand Gulf costs from the power companies. FERC then found that the four companies should take shares of the System's total nuclear power in proportion to their relative

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allocations. *Mississippi Industries v. FERC,* 808 F.2d 1525, modified on rehearing 822 F.2d 1104 (D.C. Cir.), *cert. denied,* 484 U.S. 985, 108 S.Ct. 500, 98 L.Ed.2d 499 (1987). FERC did so, and reaffirmed them; the D.C. Circuit affirmed that decision. *City of New Orleans v. FERC,* 875 F.2d 903 (D.C. Cir.1989), *cert. denied sub nom. Mississippi v. FERC,* ___ U.S. ___, 110 S.Ct. 1805, 108 L.Ed.2d 936 (1990).

Although its order did not expressly discuss the prudence of the project, FERC implicitly accepted the uncontroverted testimony of MSU executives, who explained why they believed the decision to construct and complete Grand Gulf 1 was sound. It also approved one of the ALJ's findings to that effect. *See Mississippi Power and Light v. Mississippi ex rel. Moore,* 487 U.S. 354, 362, 108 S.Ct. 2428, 2434, 101 L.Ed.2d 322 (1988).

B.

The Council is the local ratemaking body with final authority over NOPSI's retail rates. *See* 16 U.S.C. § 824(b); La.Rev.Stat. Ann. §§ 33:4405, 33:4495 (West 1988); *see also* the New Orleans Home Rule Charter § 4-1604. NOPSI applied to the Council for a retail rate increase to cover the increase in its wholesale rates resulting from the FERC allocation. The increase NOPSI sought would have resulted in an immediate 60% increase in retail rates. The Council denied an immediate rate adjustment, explaining that a public hearing was necessary to determine the "legality" and prudence of NOPSI's decision to enter the Grand Gulf contracts.

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demand for all energy generated by the system. *Mississippi Power and Light,* 108 S.Ct. at 2435. As the Council points out, NOPSI's demand is 9% of the total system demand. Thus, FERC required it to bear 9% of the System's total nuclear power costs. Since NOPSI had no nuclear plant of its own, it had to bear 17% of the Grand Gulf costs in order to bear 9% of the total nuclear power costs.

NOPSI responded by filing an action in the district court, requesting injunctive and declaratory relief, on the theory that FERC's order required the Council to allow NOPSI to pass all of the allocated costs to its retail customers. The district court dismissed the case, holding that under the Johnson Act, 28 U.S.C. § 1342, it lacked jurisdiction to proceed, and noted that if it had had jurisdiction, it would have abstained pursuant to *Burford v. Sun Oil Co.,* 319 U.S. 315, 63 S.Ct. 1098, 87 L.Ed. 1424 (1943). We reversed, but then affirmed on panel reconsideration because we decided abstention was proper under both *Burford* and *Younger v. Harris,* 401 U.S. 37, 91 S.Ct. 746, 27 L.Ed.2d 669 (1971). *NOPSI v. The City of New Orleans,* 782 F.2d 1236, *modified on panel rehearing,* 798 F.2d 858 (5th Cir.1986) (*NOPSI I*).

On October 10, 1985, while *NOPSI I* was pending before us, the Council began its investigation. In a resolution, the Council said it would examine all aspects of NOPSI's participation in the Grand Gulf projects, including Grand Gulf's impact on other power supply opportunities, and NOPSI's efforts to minimize its total cost exposure for the Grand Gulf project. The resolution specifically provided that, in determining the appropriate retail rate increase, the Council would not seek to invalidate any of the agreements surrounding Grand Gulf 1 or to order NOPSI to pay MSE a wholesale rate other than that approved by FERC.

In November 1985, with *NOPSI I* still pending before us, NOPSI filed *NOPSI II* in the district court, seeking to enjoin the Council from preventing the pass-through. The district court dismissed on ripeness grounds, and in the alternative abstained. We affirmed on the ripeness issue. *NOPSI v. The Council of the City of New Orleans,* 833 F.2d 583 (5th Cir.1987).

The Council completed its investigation on February 4, 1988, and entered a final order disallowing some of the requested in-

crease. The order prevented NOPSI from passing through $135 million of the Grand Gulf costs. This meant that, instead of passing through the full 17% FERC required it to bear, NOPSI could pass through only 14%, the amount the Council had argued NOPSI should bear in the FERC proceedings.

NOPSI then filed this action (*NOPSI III*) in the district court, and a parallel state action challenging the order. In the district court, NOPSI argued the Council's order was preempted under *Nantahala Power and Light Co. v. Thornburg,* 476 U.S. 953, 106 S.Ct. 2349, 90 L.Ed.2d 943 (1986). The district court abstained under *Burford* and we affirmed, holding abstention proper under both *Burford* and *Younger.* The Supreme Court granted certiorari and reversed, holding abstention improper on either ground. *NOPSI v. The Council of the City of New Orleans,* ___ U.S. ___, 109 S.Ct. 2506, 105 L.Ed.2d 298 (1989).

On remand, NOPSI again argued that the Council's order was preempted, because on its face it impermissibly contradicted the FERC order; or alternatively, that the Council's reasons for denying a pass-through were a pretext to attack the FERC allocation. The district court held that the Council's order was not "facially" preempted, and stayed the rest of the case because the Louisiana trial court had already issued a judgment in the Council's favor in the parallel state proceedings. The state trial court held that the Council's order was supported by substantial evidence. The matter is now pending in the state court of appeals. The district court rested its decision to stay on *Colorado River Water Conservation District v. United States,* 424 U.S. 800, 96 S.Ct. 1236, 47 L.Ed.2d 483 (1976), and *Moses H. Cone Memorial Hospital v. Mercury Construction Corporation,* 460 U.S. 1, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983). The district court did not consider the relevance of the Council members' motivation to NOPSI's pretext claim in any portion of its opinion. NOPSI brought this appeal.

II.

We first consider whether the district court properly determined that the Council's order was not "facially" preempted. The preemption doctrine is not without its difficulties. At least as a point of departure it is fair to observe that federal law may preempt state law in three ways. First, Congress may expressly define the extent to which it intends to preempt state law. Second, Congress may only signal intent to occupy an area. Third, state laws that conflict with federal laws are preempted, even if Congress has not expressly preempted them or otherwise signaled its intent to occupy the area. *Michigan Canners and Freezers Association v. Agricultural Marketing and Bargaining Board,* 467 U.S. 461, 104 S.Ct. 2518, 81 L.Ed.2d 399 (1984); *Burlington Northern R. Co. v. Public Utilities Commission of Texas,* 812 F.2d 231 (5th Cir. 1987). "Facially" preempted state laws, as the parties use the term, are those which the court can tell are preempted in one of these three ways simply by looking at the federal law, the challenged state law, and the cases applying them.

The Council argues that the Supreme Court foreclosed this claim in *NOPSI III.* As the Council concedes, the Court did not do so explicitly. Indeed, the Court reversed our holding on *Burford* abstention because the facial preemption challenge, limited as it was to the "four corners of the Council's retail rate order," would not unduly intrude into state processes or undermine the state's ability to maintain uniformity in retail rate regulation. 109 S.Ct. at 2515. Far from foreclosing the claim, the Court reversed our decision because we did not allow the district court to consider it. The Court's ensuing discussion of *Younger* abstention, however, generates some confusion. NOPSI argued that, even if *Younger* should apply to state retail rate proceedings, abstention in this case was inappropriate because a stay would cause NOPSI irreparable harm. Irreparable harm sufficient to preclude a stay occurs when the state law sought to be enforced is flagrantly and patently violative of express constitutional provisions. NOPSI argued that the same rule should apply if the state law similarly

violated federal statutes and regulatory orders, and that the Council's order was such a state law. The Court responded:

> [W]e do not have to decide the matter here, since the proceeding and order at issue do not meet that description. The Council has not sought directly to regulate interstate wholesale rates; nor has it questioned the validity of the FERC-prescribed allocation of power within the Grand Gulf system, or the FERC-prescribed wholesale rates; nor has it reexamined the prudence of NOPSI's agreement to participate in Grand Gulf 1 in the first place. Rather, the Council maintains that it has examined the prudence of NOPSI's failure, after the risk of nuclear power became apparent, to diversify its supply portfolio, and that finding that failure negligent, it has taken the normal ratemaking step of making NOPSI's shareholders rather than the ratepayers bear the consequences. Nothing in this is directly or even indirectly foreclosed by the federal statute, the regulations implementing it, or the case law applying it. There may well be reason to doubt the Council's necessary factual finding that NOPSI would have saved money had it diversified. But we cannot conclusively say it is wrong without further factual inquiry —and what requires further factual inquiry can hardly be deemed "flagrantly" unlawful for purposes of a threshold abstention determination.

109 S.Ct. at 2517. We are of course bound by the Court's characterization of the order. It is plain, however, that the Court held only that the order was not "flagrantly" unlawful for *Younger* abstention purposes; it did not hold the facial preemption claim was foreclosed. We therefore are required to consider that claim on the merits. In so doing, we must, and we will, look to the Court's characterization for such guidance as it provides.

A.

NOPSI's facial preemption claim, as well as its pretext claim, is grounded in an aspect of the filed rate doctrine, which the Court established in *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246, 71 S.Ct. 692, 95 L.Ed. 912

(1951), in dismissing a power company's challenge to the reasonableness of wholesale rates it had paid in the past. The Federal Power Commission, acting pursuant to its authority under the Federal Power Act, had determined that the challenged rates were reasonable, and the Court held that the FPC's determination settled the matter. The Court said that federal courts had no power to set a rate other than that determined by the FPC, except upon direct review of the FPC's order, and the case was not in that posture. 341 U.S. at 251–252, 71 S.Ct. at 695–696.

The Court has since held that this aspect of the filed rate doctrine applies to state courts as well, not as a rule of administrative law, as in the federal context, but rather as a means of enforcing the Supremacy Clause. *See, e.g., Arkansas Louisiana Gas Co. v. Hall,* 453 U.S. 571, 101 S.Ct. 2925, 69 L.Ed.2d 856 (1981) (state court could not allow utility to charge a wholesale rate not approved by the FPC because the state court thought the FPC would have approved the rate as reasonable; the determination of reasonableness belonged solely to the FPC).

Several state courts have held that a state utility commission setting retail rates must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price. *See, e.g., Narragansett Electric Co. v. Burke,* 119 R.I. 559, 381 A.2d 1358 (1977); *Public Service Co. of Colorado v. Public Utilities Commission,* 644 P.2d 933 (Colo.1982); *United Gas Corp. v. Mississippi Public Service Commission,* 240 Miss. 405, 127 So.2d 404 (1961). These courts viewed their decisions as applications of the filed rate doctrine. The Court has approved these cases, characterizing the decisions as "properly driven by the need to enforce the exclusive jurisdiction vested by Congress in FERC over the regulation of interstate wholesale utility rates." *Nantahala Power & Light Co. v. Thornburg,* 476 U.S. at 966, 106 S.Ct. at 2356. It is plain, then, that if the purpose or effect of the Council's order is to redetermine NOPSI's share of Grand Gulf, even if only for the purpose of setting retail rates, it is preempted by FERC's

order. *Nantahala* and *Mississippi Power and Light Co. v. Mississippi ex rel. Moore,* 487 U.S. 354, 108 S.Ct. 2428, 101 L.Ed.2d 322 (1988) guide our analysis.

In *Nantahala,* Nantahala Power and Light Co. and Tapoco, wholly owned subsidiaries of Alcoa, owned hydroelectric plants, which they allowed the TVA to operate. In exchange, the TVA provided them jointly with a fixed supply of low-cost power. Nantahala also bought high-cost power from the TVA's power grid. An agreement between Nantahala and Tapoco gave Nantahala 20% of the low-cost power, and Nantahala calculated its wholesale and retail rates on that basis. FERC reviewed this agreement in a wholesale ratemaking proceeding, and determined that the agreement was unfair and that Nantahala was entitled to 22.5% of the low cost power. FERC ordered Nantahala to use that figure in calculating its wholesale rates. When Nantahala later applied to the North Carolina Utilities Commission for a retail rate increase, the NCUC essentially determined that the agreement was more unfair to Nantahala than FERC said it was, and that Nantahala was entitled to 24.5% of the low cost power. It required Nantahala to calculate its retail rates on that basis. The Court, citing the state court cases noted above, held the NCUC's order preempted by FERC's order, because "a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable. A State must rather give effect to Congress' desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the States do not interfere with this authority." 476 U.S. at 966, 106 S.Ct. at 2356.

The Court noted that, in *Narragansett* and *Public Service Co. of Colorado,* the state courts held that an increase in FERC-ordered wholesale rates need not always lead to a corresponding increase in retail rates. Retail rates might increase less sharply than wholesale rates, or even go down, if the utility's costs *other than* those attributable to the FERC-approved wholesale rates decrease. *Narragansett,* 381 A.2d at 1363; *Public Service Co.,* 644 P.2d at 941. The Court in *Nantahala* called this qualification

"perfectly sensible," but said that it did not apply there, because the NCUC did not rest its decision on that basis, but on its disapproval of the FERC-imposed rate. 476 U.S. at 968, 106 S.Ct. at 2357.

The Court also noted that, in certain circumstances, a utility's purchase of a particular quantity of high cost power at FERC-approved rates might be unreasonable, if lower cost power were available from another source. *Id.* at 972, 106 S.Ct. at 2359. Some courts have denied pass-throughs for exactly that reason. *See Pike County Light & Power Co. v. Pennsylvania Public Utility Commission,* 77 Pa.Commw. 268, 465 A.2d 735 (1983); *Kansas-Nebraska Natural Gas Co. v. State Corporation Commission,* 4 Kan.App.2d 674, 610 P.2d 121 (1980); *Kentucky-West Virginia Gas Co. v. Pennsylvania Public Utilities Commission,* 837 F.2d 600 (3d Cir.1988). The Court determined, however, that this line of cases had no application where FERC has not only determined the rate the utility must pay for the power, but also the amount of the power the utility must purchase. In that case, there is no lower cost power available that can lessen the amount of power the utility must buy at FERC rates. 476 U.S. at 972–973, 106 S.Ct. at 2359–2360.

Mississippi Power and Light involved the same FERC allocation that is at issue here. The UPSA assigned MP & L a 31.63% share of Grand Gulf 1's costs; FERC changed that to 33%. The Mississippi Public Service Commission originally refused to allow MP & L to pass through any of these costs, but then reversed itself and allowed MP & L to pass all of them through. It did so because it concluded that MP & L would otherwise become insolvent. The Mississippi Supreme Court reversed that order, holding that the Public Service Commission had no authority under state law to allow the pass-through without conducting a prudence review, and that such a review was not preempted by federal law. The court remanded the case to the Public Service Commission to "determine whether MP & L, [MSE], and MSU acted reasonably when they constructed Grand Gulf 1, in light

of the change in demand for electric power in this state and the sudden escalation of costs." *Mississippi ex rel. Pittman v. Mississippi Public Service Commission,* 506 So.2d 978, 987 (Miss. 1987).

The Court reversed, holding that "our decision in *Nantahala* rests on a foundation that is broad enough to support the order entered by FERC in this case and to require the MPSC to treat MP & L's FERC-mandated payments for Grand Gulf costs as reasonably incurred operating expenses for the purpose of setting MP & L's retail rates." 108 S.Ct. at 2438. The Court said that *Nantahala* rested on three "fundamental principles concerning the preemptive impact of federal jurisdiction over wholesale rates on state regulation": (1) that FERC has exclusive authority to determine the reasonableness of wholesale rates; (2) that FERC's exclusive jurisdiction applies not only to rates, but also to power allocations that affect wholesale rates; and (3) that states may not bar regulated utilities from passing through to retail consumers FERC-mandated wholesale rates. 108 S.Ct. at 2439. Those principles prevented the NCUC's action in *Nantahala,* and the Court held they prevented the MPSC from conducting the prudence review ordered by the Mississippi Supreme Court. *Id.* The Court held that the *Pike County* line of cases noted above had no application, just as it had none in *Nantahala,* because FERC had determined the amount of Grand Gulf power MP & L had to buy. *Id.* 108 S.Ct. at 2440. The Court also rejected an argument that FERC did not have jurisdiction to determine the reasonableness of MP & L's decision to participate in Grand Gulf. *Id.* 108 S.Ct. at 2440–2441.[4]

In sum, then, there were several things the Council was not entitled to do in the prudence inquiry. It could not base any disallowance on NOPSI's purported imprudence in deciding to participate in Grand Gulf in the first place. That is the holding

[4]The Court's reasons for rejecting this argument were a bit murky. It stated that the reason FERC did not consider its jurisdiction was because the parties did not raise it, not because jurisdiction was lacking. Justice Scalia, concurring in the judgment, and Justice Brennan, dissenting, wrote separately to discuss the issue more thoroughly.

of *Mississippi Power and Light*. The Council could not, of course, challenge the FERC price as inappropriate. That is the point of the entire line of filed rate doctrine cases. The Council also could not penalize NOPSI for buying an unreasonably high amount of Grand Gulf power, because FERC allocated the power NOPSI had to buy. NOPSI had no legal right to take any less. *Nantahala* established that the *Pike Co.* line of cases did not apply to facts like ours; *Mississippi Power and Light* established specifically that they do not apply to our facts. We therefore must determine exactly what the Council did, and whether, in light of the cases, it was entitled to do it.

B.

We have noted that the Supreme Court has already characterized the Council's order as follows:

> The Council has not sought directly to regulate interstate wholesale rates; nor has it questioned the validity of the FERC-prescribed allocation of power within the Grand Gulf system, or the FERC-prescribed wholesale rates; nor has it reexamined the prudence of NOPSI's agreement to participate in Grand Gulf 1 in the first place. Rather, the Council maintains that it has examined the prudence of NOPSI's failure, after the risk of nuclear power became apparent, to diversify its supply portfolio, and that finding that failure negligent, it has taken the normal ratemaking step of making NOPSI's shareholders rather than the ratepayers bear the consequences.

NOPSI III, 109 S.Ct. at 2517. Even were we convinced otherwise, we are bound by the Court's characterization of the order. We agree with the Court's characterization in any event. All that is left, then, is to determine whether the foregoing preemption cases permit the Council to make this order.

C.

Nantahala and *Mississippi Power and Light* reaffirmed the well-established principle that if FERC has jurisdiction over a

subject, states cannot have jurisdiction over it. *Mississippi Power and Light* established that FERC had jurisdiction to determine whether the various utilities acted prudently in deciding to participate in the Grand Gulf venture, and that the states were therefore precluded from conducting prudence inquiries on that subject. The order before us presents a variation of that question. We must decide whether FERC has jurisdiction to determine whether NOPSI acted prudently once the Grand Gulf project was underway. To do so, we must determine whether the Federal Power Act grants FERC this jurisdiction.

The first step in making this determination is to decide whether FERC has asserted this jurisdiction. We defer to FERC's construction of the act if it does not violate the act's plain meaning and is a reasonable interpretation of silence or ambiguity. *See Mississippi Power and Light,* 108 S.Ct. at 2443 (Scalia, J., concurring in the judgment) (citing *K Mart Corp. v. Cartier, Inc.,* 486 U.S. 281, 108 S.Ct. 1811, 100 L.Ed.2d 313 (1988); *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.* 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984)). In *Mississippi Power and Light,* Justice Scalia, concurring in the judgment, and Justice Brennan, dissenting, debated whether this presumption applies to FERC's assertions of jurisdiction under the act. The majority's position on this point is not clear. It concluded that FERC did have jurisdiction over that particular prudence question. We need not enter this thicket here, however, for it is plain that FERC did not assert jurisdiction to determine NOPSI's prudence in not acting to minimize its losses.[5]

[5]NOPSI argues vigorously that the Council's order essentially relitigates several matters FERC had already decided. Appellant's brief at 43–48. We have already rejected this argument, relying on *NOPSI III.* See part II.B of this opinion. If the Council's order did this, the Court in *NOPSI III* would not have been able to conclude that nothing in the order was directly or indirectly foreclosed by the FERC order. In any event, the opposite conclusion still would not compel us to hold FERC asserted jurisdiction to decide NOPSI's prudence in not acting to mini-

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We therefore must determine only whether this is a matter that Congress has nevertheless committed to FERC's exclusive jurisdiction. In doing so, we must presume that state law is not preempted, as this is an area traditionally regulated by the states under their historic police powers. Courts must assume that these state powers were not to be superseded by the Act in the absence of clear and manifest Congressional purpose. *California v. ARC America Corp.,* 490 U.S. 93, 109 S.Ct. 1661, 104 L.Ed.2d 86 (1989); *Rice v. Santa Fe Elevator Corp.,* 331 U.S. 218, 67 S.Ct. 1146, 91 L.Ed. 1447 (1947). We are pointed to nothing to suggest that Congress has done so.[6] Indeed, finding such jurisdiction would work the result Justice Brennan feared in *Mississippi Power and Light,* that is, to "divest states of authority to determine the prudence of costs incurred by retail utilities whenever those utilities belong to an interstate pool." 108 S.Ct. at 2449 (Brennan, J., dissenting). We would require a firmer statement of intent to preempt before finding such intrusive federal jurisdiction to exist.

Further, we are convinced that the Court in *NOPSI III* did not believe the Council could not regulate NOPSI's activities in this regard. It said that nothing in the Council's order was directly or even indirectly foreclosed by prior preemption decisions. *NOPSI III,* 109 S.Ct. at 2517. Indeed, this seems analogous to the excep-

mize its losses. We would only be compelled to conclude that some of the issues that were relevant to FERC's wholesale rate proceeding were also relevant to the Council's proceeding. Of course, in that case, the Council would have been bound by FERC's resolution of those issues.

[6]Congress of course need not expressly grant FERC the power to preempt a particular state action. Rather, when state law is alleged to be preempted by federal regulation, the court must determine whether the agency action is preemptive (making the same inquiry as for a statute); the agency's choice to act preemptively will be upheld whenever the action "represents a reasonable accommodation of . . . policies that were committed to the agency's care by the statute." *City of New York v. F.C.C.,* 486 U.S. 57, 63, 108 S.Ct. 1637, 1642, 100 L.Ed.2d 48 (1988). Nevertheless, the grant of regulatory authority can itself be preemptive. *See Schneidewind v. ANR Pipeline Co.,* 485 U.S. 293, 108 S.Ct. 1145, 99 L.Ed.2d 316 (1988).

tion the Court called "perfectly sensible" in *Nantahala,* 476 U.S. at 968, 106 S.Ct. at 2357; *see Narragansett,* 381 A.2d at 1363; *Public Service Co.,* 644 P.2d at 941. If states may deny pass throughs because costs have gone down in other areas, it seems logical that they should be able to deny them because costs would have gone down if the utility had not been imprudent. We therefore hold the order is not facially preempted.

III.

As we have noted, NOPSI has not rested its preemption argument solely on the Council order's facial invalidity. NOPSI also argues that, whatever the order's facial validity, the reasons given for denying the pass through were pretexts for the Council members' true, but impermissible, objective of attacking both the FERC allocation and NOPSI's imprudence in participating in Grand Gulf in the first place. We are unable to locate an express reference to this aspect of NOPSI's argument in the district court's opinion.[7]

In its brief and at oral argument, the Council urged that NOPSI never raised this pretext claim in its complaint. Whether we would reach the same conclusion on a fresh reading of the

[7]As we will explain, the district court premised its decision to stay in large part upon its conclusion that there were no substantial federal issues remaining in the case, once it had resolved the facial preemption challenge. The district court said that the disposition of the facial challenge "leaves only the question of whether the Council's finding is supported by the evidence." At 997. At oral argument, the parties and the panel proceeded on the assumption that the district court ignored the pretext claim. On further reflection and examination of the opinion, we cannot conclusively say that is so. It is equally plausible to read the district court's language to mean that the court thought the pretext claim involved only an analysis of the sufficiency of the evidence, a conclusion with which we agree. We can only conclusively say that the district court did not expressly refute the argument that the pretext claim must involve an evaluation of the Council's motivation in making the rate order.

complaint is not relevant, however, because the Supreme Court has already held that NOPSI did raise this claim in its complaint. *NOPSI III*, 109 S.Ct. at 2515 ("It is true that in its initial complaint, NOPSI asserted, as an alternative to its facial preemption challenge, that the rate order's nominal emphasis on NOPSI's failure in 1979–80 to diversify its power supply by selling off a portion of its Grand Gulf allocation was merely a cover for the determination that the original Grand Gulf investment was unwise").

The Council further argued that the district court's decision to stay was justifiable under *Colorado River* and *Moses H. Cone Memorial Hospital*, despite the failure to consider expressly the relevance of motivation to the pretext claim. We review the decision to stay only for an abuse of discretion. *Moses H. Cone Memorial Hospital,* 460 U.S. at 19, 103 S.Ct. at 938; *Brown v. Link Belt Division of FMC Corp.*, 666 F.2d 110 (5th Cir. 1982). Under *Colorado River* and *Moses H. Cone Memorial Hospital*, the district court was required to consider whether the case presented exceptional circumstances, in which considerations of wise judicial administration—in particular the need to conserve judicial resources and promote comprehensive disposition of litigation—counselled against exercising jurisdiction. *Colorado River*, 424 U.S. at 817, 96 S.Ct. at 1246. Several factors guide this decision, none of which is necessarily determinative. *Id*. The court was required to consider the convenience of the federal forum, the desirability of avoiding piecemeal litigation, the order in which the federal and state forums obtained jurisdiction and the progress of the litigation in each, whether there existed a *res* over which one forum or both had asserted jurisdiction, which forum's law provided the rule of decision in the case, and the adequacy of the state court proceedings to protect NOPSI's rights. *Colorado River*, 424 U.S. at 819–820, 96 S.Ct. at 1247–1248; *Moses H. Cone Memorial Hospital*, 460 U.S. at 24–27, 103 S.Ct. at 941–943. The court was not to apply these factors as a mechanical checklist, but

rather to balance carefully the factors important in the particular setting of the case. It was also to weight the balance heavily in favor of exercising jurisdiction. *Moses H. Cone Memorial Hospital*, 460 U.S. at 16, 103 S.Ct. at 937.

The Council maintained that, as long as there was sufficient evidence to support the Council's stated reasons for denying the pass through, the pretext claim must fail, that there was no difference between the pretext claim and the state law challenges to the order's validity. Since the state trial court had already decided the state law challenges, and thereby already passed, albeit indirectly, on the pretext claim, the Council contended the district court properly concluded that, while federal law technically provided the rule of decision, there were no substantial federal issues remaining in the case, so the court was not compelled to exercise its jurisdiction on that basis. The Council further argued that the district court's order was not otherwise an abuse of discretion.

A.

In *NOPSI III*, the Court described the pretext claim as follows:

> Unlike the facial challenge, [the pretext] claim cannot be resolved on the face of the rate order, because it hinges largely on the plausibility of the Council's finding that NOPSI should have, and could have, diversified its supply portfolio and thereby lowered its average wholesale costs. See n. 2, supra. Analysis of this pretext claim requires an inquiry into industry practice, wholesale rates, and power availability during the relevant time period, an endeavor that demands some level of industry-specific expertise.

109 S.Ct. at 2515. The reference in this language to the earlier footnote provides further guidance. In that footnote, the Court quoted from the prior district court opinion, in which the district court expressed doubts as to the validity of the Council's stated reasons for denying the pass through:

> Adverting to the merits, the District Court commented: "[T]he Council faults NOPSI not for buying a 'pig in a poke' but for failing to find a sucker to buy it when the faux pas became apparent."[11]
>
> [11]P.T. Barnum once said of suckers: 'There's one born every minute.' This court, however, is not ready to assume there are many, if any, such suckers purchasing electricity in the wholesale market today. Indeed, this court is somewhat mystified by the Council's logic in arriving at the $135 million disallowance in the Rate Order. In the Rate Order, the Council simply concluded that since [NOPSI's President] said so, savings were actually possible. Then, the Council seemingly pulled from thin air a figure of 8% for the prudence disallowance. However, the Council, and in this case, everyone else knows that the 8% figure was not pulled from thin air but represents the difference between FERC's 17% allocation and what NOPSI consistently claims as its relative share of the [Middle South] system [and what the Council advocated unsuccessfully in the FERC proceeding], i.e., 9%. Thus, the disallowed costs bear no apparent relationship to the savings NOPSI is said to have foregone. [sic] Must not the 'savings' posited as the reason for the disallowance be at least possible in the actual economic market? Furthermore, must not the ultimate disallowance bear some rational relationship to the possible savings which support the disallowance? These questions must be resolved on another day in another court.

109 S.Ct. at 2512, n. 2. This language suggests that the Court meant the pretext claim is inevitably a review of the sufficiency of the evidence to support the Council's stated reasons for denying the pass through. But NOPSI argues the language should be read to require a further inquiry, a determination of the Council members' motivation in making the order, regardless of the evidence. We disagree. We have said that, facially, the Council's order was a valid exercise of its power over retail rates. If there is an adequate basis in the record to support the Council's action, federal courts may not invalidate it on a suspicion that the Council members' motives were improper. See *Fletcher v. Peck*, 6 Cranch. 87, 128–130, 3 L.Ed. 162 (1810); *Arizona v. California*, 283 U.S. 423, 455 n. 7, 51 S.Ct. 522, 526 n. 7, 75 L.Ed. 1154 (1931); *United States v. O'Brien*, 391 U.S. 367, 382–386, 88 S.Ct.

1673, 1681–1684, 20 L.Ed.2d 672 (1968); *Palmer v. Thompson,* 403 U.S. 217, 91 S.Ct. 1940, 29 L.Ed.2d 438 (1971). Of course, the evaluation of the sufficiency of the evidence must be made with an eye to the circumstances of the case; but beyond that we cannot go. We do not read *NOPSI III* to require otherwise.

Having reached this conclusion, we cannot reverse the district court for failing expressly to consider the relevance of motivation to the pretext claim in deciding to stay its hand. The pretext claim has little functional difference from the state court's sufficiency of the evidence review, and motivation is not relevant. We therefore can reverse only if the district court's order was otherwise an abuse of discretion.

B.

Not all of the factors set out in *Colorado River* and *Moses H. Cone* are important in every case, and only some are important here. In this case, the forums are equally convenient,[8] there is no *res,* and the question of the order in which jurisdiction was actually obtained is confusing and largely academic. We have already determined that there are no substantial federal issues remaining in the case. We therefore focus on the factors that are important

[8]The district court noted that "[t]he factor of convenience usually refers to ease of access to sources of proof, availability of compulsory process, and enforceability of judgments," and that in this sense, neither forum in this case was more convenient than the other. But the court still found the federal forum inconvenient because "it is certainly inconvenient for the parties to pursue two concurrent, parallel litigations in two courts within the same parish in Louisiana." At 996. This approach unnecessarily confuses the analysis. The Court in *Colorado River* plainly considered convenience to mean roughly what it does in *forum non conveniens* analysis, as its reference to *Gulf Oil Corp. v. Gilbert,* 330 U.S. 501, 67 S.Ct. 839, 91 L.Ed. 1055 (1947) indicates. 424 U.S. at 818, 96 S.Ct. at 1246. The other difficulties of proceeding in parallel forums—waste of judicial resources, duplication of effort, expense—are more properly considered in determining whether it is appropriate to stay in order to avoid piecemeal litigation.

—the progress of the proceedings in each forum, the adequacy of the state courts to protect NOPSI's rights, and avoiding piecemeal litigation.

The district court was correct that the state proceeding had progressed further than the federal one, since the state trial court had already rendered judgment on the merits of the sufficiency of the evidence claim. The Council's argument that the state trial court's judgment is entitled to res judicata effect is contrary to Louisiana law, see La.Civ.Code Art. 3556(31) (West 1990); but the fact that the state trial court has rendered judgment nonetheless weighs in favor of a stay. There is little to be gained from rehashing the same evidence in another forum.

The state courts are of course quite adequate to protect NOPSI's rights. Indeed, they are more experienced in reviewing retail rate orders than are federal courts. This factor also weighs in favor of a stay.

Colorado River was based primarily upon avoiding piecemeal litigation. Colorado had established a comprehensive system for adjudicating water rights, and it was plain that the relevant federal policies in the McCarran Act favored adjudicating water rights in a single, unified proceeding. 424 U.S. at 819–820, 96 S.Ct. at 1247–1248. The Johnson Act just as clearly evidences a federal purpose to facilitate review of state court retail rate orders in unified proceedings, and indeed in unified proceedings in state court. 28 U.S.C. § 1342; *see Gulf Water Benefaction Co. v. Public Utility Commission,* 674 F.2d 462 (5th Cir.1982). We have held the Johnson Act not applicable to these proceedings, because the preemption claim was based on the Federal Power Act as well as the Constitution, *NOPSI I,* 782 F.2d at 1242–1243; but that holding does not diminish the federal interest in state court resolution of challenges to state rate orders. Further, it is plain that all necessary parties are before the state court and all claims can be adjudicated there. *See Brillhart v. Excess Insurance Co. of Ameri-*

ca, 316 U.S. 491, 495, 62 S.Ct. 1173, 1175, 86 L.Ed. 1620 (1941). The district court thus properly concluded that the desire to avoid piecemeal litigation counselled in favor of a stay.

The district court's discretion to stay decision pursuant to *Colorado River* is perhaps not as broad as was once thought. Compare *Will v. Calvert Fire Insurance Co.,* 437 U.S. 655, 98 S.Ct. 2552, 57 L.Ed.2d 504 (1978) (plurality opinion) and *Moses H. Cone Memorial Hospital,* 460 U.S. at 16–19, 103 S.Ct. at 937–939. The district court of course has broad control over its docket, but that control is limited by the virtually unflagging obligation to exercise its jurisdiction. *See Moses H. Cone Memorial Hospital,* 460 U.S. at 19, 103 S.Ct. at 938. Here, however, three factors counsel strongly in favor of a stay, and there are no substantial federal questions remaining in the case. Under these circumstances, we cannot say the district court abused its discretion.

IV.

Finding no merit in NOPSI's facial preemption challenge, and that the district court properly stayed the pretext challenge, we affirm the judgment of the district court.

AFFIRMED.

DISTRICT COURT OPINION AND ORDER [JANUARY 4, 1990]

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF LOUISIANA

NEW ORLEANS PUBLIC SERVICE, INC. *VERSUS* THE COUNCIL OF THE CITY OF NEW ORLEANS, ET AL	CIVIL ACTION NO. 88-559 SECTION "D" (2)

Before the court is the Motion of Defendants, the Council of the City of New Orleans, et al, to Dismiss on Grounds of *Res Judicata.* Plaintiff, New Orleans Public Service, Inc. ("NOPSI"), opposes this Motion. The Motion, set to be heard on Wednesday, December 13, 1989, is before the court on briefs without oral argument.

The issue of *res judicata* need not be considered at this time since the court, on its own motion, has decided to stay this matter due to the progress of the concurrent state court proceedings. A decision regarding a stay requires the court to examine the following two issues: (1) is the Council's Rate Order facially preempted by the Federal Energy Regulatory Commission's ("FERC") allocative decree; and (2) if the Order is not facially preempted, should the court stay this matter in deference to the parallel state court proceeding which is currently on appeal to the Louisiana Court of Appeal. Each issue will be discussed in turn.

1. In *New Orleans Public Service v. Council of City of New Orleans,* 109 S.Ct. 2506, 2515 (1989), the Supreme Court noted that the federal preemption issue in this litigation should be decided only by reviewing the Council's Rate Order. The Court held that "no inquiry beyond the four corners of the Council's retail rate order is needed to determine whether it is facially preempted by FERC's allocative decree . . . ." *Id.* at 2515. Facially, the Council's Order is not preempted by federal law. The Council noted that "neither the purpose nor the effect of this prudence

investigation is to interfere with interstate commerce." Prudence Investigation, pp. 41-2. Instead, the Council merely sought "to review the prudence of the management of NOPSI . . . as to the action it took and could have taken, so as to ensure that only prudently incurred costs are passed on to New Orleans' consumers in their local electric rates." *Id.* at 44. The Council concluded:

> Were we to adopt a different allocation formula as the basis for retail rates than that adopted by the FERC for wholesale rates, such an action would certainly be in derogation of the FERC's authority and violate the Supremacy Clause of the Constitution. *Nantahala Power & Light Co. v. Thornburg,* 106 S.Ct. 2349 (1986). But we do not do so. The inquiry here falls within the area reserved by *Nantahala*—i.e., whether there were alternatives by which NOPSI could have curtailed its costs and risks with respect to Grand Gulf. Moreover, there was no independent issue of the prudence of management in the *Nantahala* case as, in contrast, there is here. *Id.* at 48.

An examination into the "four corners" of the Council's Order reveals that it is not facially preempted. The Council's decision did not question the validity of FERC's allocative decree, and the Council did not attempt to regulate interstate utility rates. Instead, the Council's inquiry focused solely upon whether NOPSI prudently managed its participation in Grand Gulf. Accordingly, this court concurs with the Louisiana Civil District Court by holding that the Council's Rate Order is not facially preempted by FERC's allocative decree.

2. Since this matter is not preempted, the Court will now address whether a stay is appropriate regarding NOPSI's claim that the Council's Order is unsupported by the evidence. The decision of whether to stay federal proceedings because of parallel state court litigation is committed to a district court's discretion. A court's decision to stay can only be reversed for an abuse of discretion. *Brown v. Link Belt Division of FMC Corp.*, 666 F.2d 110, 115 (5th Cir. 1982); *Illinois Bell Telephone Co. v. Illinois*

Commerce Commission, 740 F.2d 566, 569 (7th Cir. 1984). This discretion stems from a district court's "inherent power to control its docket." *Sea Colony, Inc. v. Alcan Aluminum Corp.*, 653 F. Supp. 1323, 1326 (D.Del. 1987). In order to stay a proceeding, two prerequisites must be satisfied. First, the state and federal proceedings must be parallel. *Glen Oaks Utilities, Inc. v. City of Houston*, 280 F.2d 330 (5th Cir. 1960); *Gilbane Bldg. Co. v. Nemours Foundation*, 568 F. Supp. 1085, 1089 (D.Del. 1983). The mere fact that a parallel action between the parties is pending in state court is not a bar to the federal proceedings. *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1, 14, 103 S.Ct. 927, 936 (1983). However, "parallel actions may lead to . . . 'a grand waste of efforts by both the courts and parties.' " *Illinois Bell*, 740 F.2d at 569, quoting, *MicroSoftware Computer Systems v. Ontel Corp.*, 686 F.2d 531, 538 (7th Cir. 1982).

Second, adequate grounds must exist to justify granting the stay. In *Colorado River Water Conservation Dist. v. United States*, 424 U.S. 800, 96 S.Ct. 1236 (1976), the Court held that under exceptional circumstances, a stay may be appropriate based upon "considerations of '[w]ise judicial administration, giving regard to conservation of judicial resources and comprehensive disposition of litigation.' " *Id.* at 817, 96 S.Ct. at 1246, quoting *Kerotest Mfg. Co. v. C-O-Two Fire Equipment Co.*, 342 U.S. 180, 183, 72 S.Ct. 219, 221 (1952). The *Colorado River* Court noted that the "general principal is to avoid duplicative litigation." 96 S.Ct. at 1246. The Court then delineated several factors which can justify a stay, holding that "[n]o one factor is necessarily determinative; a carefully considered judgment taking into account both the obligation to exercise jurisdiction and the combination of factors counselling against that exercise is required." *Id.* at 819, 96 S.Ct. at 1247. The factors enunciated by the court include: (1) the inconvenience of the federal forum; (2) the desirability of avoiding piecemeal litigation; (3) the order in which the proceedings were initiated; and (4) the presence of a *res* or property over which jurisdiction has

been asserted. *Id.* at 819-20, 96 S.Ct. at 1246. In *Moses H. Cone*, the Court added two additional factors: (1) whether federal law provides the rule of decision on the merits; and (2) the adequacy of state court proceedings to protect the plaintiff's rights. 460 U.S. at 24-27, 103 S.Ct. at 941-42. This court will consider each factor in turn.

1. *INCONVENIENCE OF THE FEDERAL FORUM*

This litigation is currently taking place in both this court and the Louisiana Civil District Court for the Parish of Orleans. The factor of convenience usually refers to ease of access to sources of proof, availability of compulsory process, and enforceability of judgments. *Gulf Oil Corp. v. Gilbert*, 330 U.S. 501, 508, 67 S.Ct. 839, 843 (1947). While litigation in this court is not inconvenient when measured against those standards, it is certainly inconvenient for the parties to pursue two concurrent, parallel litigations in two courts within the same parish in Louisiana. This case has clearly commanded much judicial resources. No aspect of this case has been easy, expeditious or inexpensive. Since an appeal is pending from the state court judgment, this court finds that it is inconvenient to proceed at this time in federal court. *See Glen Oaks*, 280 F.2d at 334.

2. *AVOIDANCE OF PIECEMEAL LITIGATION*

Consideration of this factor requires the district court to inquire into the scope of the proceeding and nature of available defenses in the pending state court litigation. *Gilbane*, 568 F. Supp. at 1090. This court must consider whether "the claims of all parties in interest can satisfactorily be adjudicated in that proceeding, whether necessary parties have been joined, [and] whether such parties are amenable to process in that proceeding." *Brillhart v. Excess Ins. Co.*, 316 U.S. 491, 495, 62 S.Ct. 1173, 1176 (1942). The scope of the state court proceeding is identical to the proceeding in this court. The same parties are involved, and all

of the claims can be satisfactorily adjudicated in the state court. Moreover, the nature and availability of defenses are the same in both courts. Since the state court judgment is currently on appeal to the Louisiana Court of Appeal for the Fourth Circuit, judgment by this court on the merits would inevitably result in two parallel appellate tracks. This result is not only unnecessary, but also it would greatly increase the expense and complexity of this litigation. Furthermore, the parties run the risk of having conflicting adjudications.

3. *ORDER IN WHICH JURISDICTION WAS OBTAINED*

The procedural history of this litigation is quite complicated. Since August 1, 1985, three successive lawsuits have been filed in federal court. State court litigation commenced in February, 1988, when the Council raced to the courthouse and filed a Petition for Declaratory and Injunctive Relief within minutes of the Council's issuance of its Rate Order. While the state court litigation was proceeding, NOPSI filed another complaint in this court on February 9, 1989, for Preliminary and Permanent Injunction and Declaratory Relief. On November 15, 1989, Judge DiRosa issued a decision in state court, and the matter is currently on appeal.

Technically, in the present stance of this litigation, the state court assumed jurisdiction first, at least of those issues directly involved with the factual findings that form the basis of the Council's Rate Order. In essence, however, the multitude of cases filed in this dispute represent one continuous process of litigation.

However, the analysis of this factor "as with the other *Colorado River* factors, is to be applied in a pragmatic, flexible manner with a view to the realities of the case at hand. Thus, priority should not be measured exclusively by which complaint was filed first, but rather in terms of how much progress has been made in the two actions." *Moses H. Cone*, 460 U.S. at 21, 103 S.Ct. at 940. In this litigation's current phase, there has been more progress in

the Louisiana court. The Civil District Court has already rendered judgment, and it is presently on appeal. The progress of the state court proceeding is the most dispositive consideration in applying the *Colorado River* factor of the order in which jurisdiction was obtained.

4. *PRESENCE OF RES OR PROPERTY*

Since jurisdiction has not been obtained over a *res* in this matter, this factor is not dispositive.

5. *RULE OF DECISION ON THE MERITS*

The absence of a state law claim does not affect the court's decision to stay the instant litigation. This court's holding that the Council's Rate Order is not facially preempted by federal law leaves only the question of whether the Council's finding is supported by the evidence. This factual determination does not involve serious issues regarding the interpretation or application of federal law.

6. *ADEQUACY OF STATE COURTS*

Louisiana state courts are fully able to redress Plaintiff's complaints. NOPSI has not denied that adequate state remedies exist. Moreover, the local nature of the controversy militates in favor of allowing this litigation to complete the appellate process in the state courts.

In addition to the factors in *Colorado River* and *Moses H. Cone*, the court also notes other considerations which enter into this balancing test. First, there is a "strong federal policy against federal court interference with pending state judicial proceedings absent extraordinary circumstances." *Middlesex County Ethics Committee v. Garden State Bar Ass'n*, 457 U.S. 423, 431, 102 S.Ct. 2515, 2521 (1982). This policy is motivated by comity concerns

which dictate "a proper respect for state functions, . . . and a continuance of the belief that the National Government will fare best if the States and their institutions are left free to perform their separate functions in their separate ways." *Younger v. Harris*, 401 U.S. 37, 44, 91 S.Ct. 746, 750 (1971). Comity concerns are particularly relevant when there is a possibility of conflicting adjudications. Differing results "could engender difficult problems in reaching an ultimate disposition of the issues involved in the litigation." *Sea Colony, Inc.*, 653 F. Supp. at 1329.

Second, judicial economy weighs heavily in favor of staying this proceeding. Separate adjudications will result in a needless reduplication of effort, greatly increasing the expense and difficulty of this litigation. To continue with this proceeding in the federal court would elevate "form over substance in adhering to the proposition that federal courts have an 'unflagging obligation' to exercise jurisdiction." *Id.*

For the foregoing reasons, the court has decided to stay this matter pending review of the state court decision.

Accordingly, IT IS ORDERED that the instant action be STAYED without prejudice. The court will lift this Stay, on a Rule to Show Cause, if NOPSI demonstrates that the City Council is purposely delaying the appellate process in state court.

New Orleans, Louisiana, this 3 day of Jan, 1990.

/s/ A.J. McNamara
United States District Judge

COURT OF APPEALS ORDER DENYING PETITION FOR REHEARING [OCTOBER 17, 1990]

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 90-3050

NEW ORLEANS PUBLIC SERVICE, INC.,

Plaintiff-Appellant,

versus

THE COUNCIL OF THE CITY OF NEW ORLEANS, ET AL.,

Defendants-Appellees.

Appeal from the United States District Court for the Eastern District of Louisiana

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ON PETITION FOR REHEARING

(October 17, 1990)

Before WISDOM, HIGGINBOTHAM and DUHE, Circuit Judges.

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause be and the same is hereby denied.

ENTERED FOR THE COURT:

/s/ PATRICK E. HIGGINBOTHAM

United States Circuit Judge

EXCERPTS FROM THE FEDERAL POWER ACT, 16 U.S.C. §§ 791a–828c

Section 201, 16 U.S.C. § 824:

Declaration of policy; application of subchapter

(a) Federal regulation of transmission and sale of electric energy

It is declared that the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation of matters relating to generation to the extent provided in this subchapter and subchapter III of this chapter and of that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States.

(b) Use or sale of electric energy in interstate commerce

(1) The provisions of this subchapter shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce, but except as provided in paragraph (2) shall not apply to any other sale of electric energy or deprive a State or State commission of its lawful authority now exercised over the exportation of hydroelectric energy which is transmitted across a State line. The Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy, but shall not have jurisdiction, except as specifically provided in this subchapter and subchapter III of this chapter, over facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter.

* * *

(c) Electric energy in interstate commerce

For the purpose of this subchapter, electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof; but only insofar as such transmission takes place within the United States.

(d) "Sale of electric energy at wholesale" defined

The term "sale of electric energy at wholesale" when used in this subchapter, means a sale of electric energy to any person for resale.

(e) "Public utility" defined

The term "public utility" when used in this subchapter and subchapter III of this chapter means any person who owns or operates facilities subject to the jurisdiction of the Commission under this subchapter (other than facilities subject to such jurisdiction solely by reason of section 824i, 824j or 824k of this title).

* * *

Section 205, 16 U.S.C. § 824d:

Rates and charges; schedules; suspension of new rates; automatic adjustment clauses

(a) Just and reasonable rates

All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) Preference or advantage unlawful

No public utility shall, with respect to any transmission or sale subject to the jurisdiction of the Commission, (1) make or grant

any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Schedules

Under such rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Notice required for rate changes

Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after sixty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the sixty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Suspension of new rates; hearings; five month period

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint or upon its own initiative

without complaint, at once, and, if it so orders, without answer or formal pleading by the public utility, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the public utility affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of such five months, the proposed change of rate, charge, classification, or service shall go into effect at the end of such period, but in case of a proposed increased rate or charge, the Commission may by order require the interested public utility or public utilities to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require such public utility or public utilities to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

(f) Review of automatic adjustment clauses and public utility practice; action by Commission; definition

(1) Not later than 2 years after November 9, 1978, and not less often than every 4 years thereafter, the Commission shall make a thorough review of automatic adjustment clauses in public utility rate schedules to examine—

(A) whether or not each such clause effectively provides incentives for efficient use of resources (including economical purchase and use of fuel and electric energy), and

(B) whether any such clause reflects any costs other than costs which are—

(i) subject to periodic fluctuations and

(ii) not susceptible to precise determinations in rate cases prior to the time such costs are incurred.

Such review may take place in individual rate proceedings or in generic or other separate proceedings applicable to one or more utilities.

(2) Not less frequently than every 2 years, in rate proceedings or in generic or other separate proceedings, the Commission shall review, with respect to each public utility, practices under any automatic adjustment clauses of such utility to insure efficient use of resources (including economical purchase and use of fuel and electric energy) under such clauses.

(3) The Commission may, on its own motion or upon complaint, after an opportunity for an evidentiary hearing, order a public utility to—

(A) modify the terms and provisions of any automatic adjustment clause, or

(B) cease any practice in connection with the clause,

if such clause or practice does not result in the economical purchase and use of fuel, electric energy, or other items, the cost of

which included in any rate schedule under an automatic adjustment clause.

(4) As used in this subsection, the term "automatic adjustment clause" means a provision of a rate schedule which provides for increases or decreases (or both), without prior hearing, in rates reflecting increases or decreases (or both) in costs incurred by an electric utility. Such term does not include any rate which takes effect subject to refund and subject to a later determination of the appropriate amount of such rate.

Section 206, 16 U.S.C. § 824e:

Power of Commission to fix rates and charges; determination of cost of production or transmission

(a) Unjust or preferential rates, etc.

Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affected such rate, charge, or classification is injust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.

(b) Refund effective date; preferential proceedings; statement of reasons for delay; burden of proof; scope of refund order; refund orders in cases of dilatory behavior; interest

Whenever the Commission institutes a proceeding under this section, the Commission shall establish a refund effective date. In the case of a proceeding instituted on complaint, the refund effective date shall not be earlier than the date 60 days after the

filing of such complaint nor later than 5 months after the expiration of such 60-day period. In the case of a proceeding instituted by the Commission on its own motion, the refund effective date shall not be earlier than the date 60 days after the publication by the Commission of notice of its intention to initiate such proceeding nor later than 5 months after the expiration of such 60-day period. Upon institution of a proceeding under this section, the Commission shall give to the decision of such proceeding the same preference as provided under section 824d of this title and otherwise act as speedily as possible. If no final decision is rendered by the refund effective date or by the conclusion of the 180-day period commencing upon initiation of a proceeding pursuant to this section, whichever is earlier, the Commission shall state the reasons why it has failed to do so and shall state its best estimate as to when it reasonably expects to make such decision. In any proceeding under this section, the burden of proof to show that any rate, charge, classification, rule, regulation, practice, or contract is unjust, unreasonable, unduly discriminatory, or preferential shall be upon the Commission or the complainant. At the conclusion of any proceeding under this section, the Commission may order the public utility to make refunds of any amounts paid, for the period subsequent to the refund effective date through a date fifteen months after such refund effective date, in excess of those which would have been paid under the just and reasonable rate, charge, classification, rule, regulation, practice, or contract which the Commission orders to be thereafter observed and in force: *Provided,* That if the proceeding is not concluded within fifteen months after the refund effective date and if the Commission determines at the conclusion of the proceeding that the proceeding was not resolved within the fifteen-month period primarily because of dilatory behavior by the public utility, the Commission may order refunds of any or all amounts paid for the period subsequent to the refund effective date and prior to the conclusion of the proceeding. The refunds shall be made, with interest, to those persons who have paid those rates or charges which are the subject of the proceeding.

(c) Refund considerations; shifting costs; reduction in revenues; "electric utility companies" and "registered holding company" defined

Notwithstanding subsection (b) of this section, in a proceeding commenced under this section involving two or more electric utility companies of a registered holding company, refunds which might otherwise be payable under subsection (b) of this section shall not be ordered to the extent that such refunds would result from any portion of a Commission order that (1) requires a decrease in system production or transmission costs to be paid by one or more of such electric companies; and (2) is based upon a determination that the amount of such decrease should be paid through an increase in the costs to be paid by other electric utility companies of such registered holding company: *Provided,* That refunds, in whole or in part, may be ordered by the Commission if it determines that the registered holding company would not experience any reduction in revenues which results from an inability of an electric utility company of the holding company to recover such increase in costs for the period between the refund effective date and the effective date of the Commission's order. For purposes of this subsection, the terms "electric utility companies" and "registered holding company" shall have the same meanings as provided in the Public Utility Holding Company Act of 1935, as amended [15 U.S.C. 79 et seq.]

(d) Investigation of costs

The Commission upon its own motion, or upon the request of any State commission whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy.

Section 306, 16 U.S.C. § 825e:

Any person, State, municipality, or State commission complaining of anything done or omitted to be done by any licensee

or public utility in contravention of the provisions of this chapter may apply to the Commission by petition which shall briefly state the facts, whereupon a statement of the complaint thus made shall be forwarded by the Commission to such licensee or public utility, who shall be called upon to satisfy the complaint or to answer the same in writing within a reasonable time to be specified by the Commission. If such licensee or public utility shall not satisfy the complaint within the time specified or there shall appear to be any reasonable ground for investigating such complaint, it shall be the duty of the Commission to investigate the matters complained of in such manner and by such means as it shall find proper.

EXCERPTS FROM THE CONSTITUTION OF THE UNITED STATES

The Commerce Clause (art. I, § 8, cl. 3):

> The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States and with the Indian Tribes . . . .

The Supremacy Clause (art. VI, cl. 2):

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

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No. 90-1156

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*,
Respondents.

On Petition For Writ Of Certiorari To The United States Court of Appeals For The Fifth Circuit

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TABLE OF CONTENTS

	Page
TABLE OF CONTENTS	i
TABLE OF AUTHORITIES	ii
STATEMENT OF THE CASE	1
A. Introduction	1
B. The Parties	5
C. The MSU "System"	6
D. Grand Gulf	7
E. The FERC Proceedings	8
F. The Council's Ratemaking Proceedings	9
G. The Rate Order and "*NOPSI III*"	10
H. The State Court Proceedings	11
REASONS FOR DENYING THE PETITION	12
1. The Petitioner Simply Misportrays The Facts Here, And Those In Other Cases, As It Did In *NOPSI III*	12
2. The Decision Below Leaves The FERC's Jurisdiction Fully Intact	15
3. There Are No Decisions In Conflict With The Ruling Below	18
4. No Review Should Be Undertaken Here In Light Of The Prior State Court Judgment	19
5. There Is No Significant Issue Meriting Review	21
CONCLUSION	22

TABLE OF AUTHORITIES

Page

CASES

Alliance for Affordable Energy, Inc. v. Council of New Orleans, No. 88-2502 (La. Civ. Dist. Ct. filed Feb. 4, 1988) 11

Boissiere v. NOPSI, No. 88-2503 (La. Civ. Dist. Ct. filed Feb. 4, 1988) 11

Coleman v. Comm'n on Ethics for Public Employees, 439 So.2d 451 (La. App. 1983) 20

Eastern Edison Co. v. Department of Public Utilities, 446 N.E.2d 684 (Mass. 1983) 19

Federal Power Comm'n v. Southern Cal. Edison Co., 376 U.S. 205 (1964) 14

Hospital Corp. of America v. Robinson, 506 So.2d 938 (La. App. 1987) 20

McConnell v. Travelers Indemnity Co., 346 F.2d 219 (5th Cir. 1965) 20

Mente & Co. v. Anciens Etablissements Verdier-Dufour & Cie., 149 So. 492 (La. 1933) 20

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Mississippi Indus., Inc. v. FERC, 808 F.2d 1525 (D.C. Cir.), *vacated in part*, 822 F.2d 1104 (D.C. Cir.), *cert. denied*, 484 U.S. 985 (1987) 7

Mississippi Power & Light Co. v. Mississippi ex rel. Moore 487 U.S. 354 (1988) ..... *passim*

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Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953 (1986) ..... *passim*

NOPSI v. Council of New Orleans, 491 U.S. 350, 109 S. Ct. 2506 (1989) ..... *passim*

Table of Authorities Continued

Page

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NOPSI v. Council of New Orleans, No. 88-4511, slip op. (La. Civ. Dist. Ct. Nov. 15, 1989) 5,14

NOPSI v. Council of New Orleans, No. 90-CA-0420 (La. Ct. App. 4th Cir.) 11

Northern States Power Co. v. Hagen, 314 N.W.2d 32 (N.D. 1981) 19

Northern States Power Co. v. Minnesota Public Utilities Comm'n, 344 N.W.2d 374 (1984), *cert. denied*, 467 U.S. 1256 (1984) 19

Northwest Cent. Pipeline Corp. v. State Corp. Comm'n, 489 U.S. 493 (1989) 15

Panhandle Eastern Pipeline Co. v. Public Serv. Comm'n of Indiana, 332 U.S. 507 (1947) 15

Thomas v. Dept. of Corrections, 430 So.2d 1153 (La. App.), *cert. denied*, 435 So.2d 432 and 438 So.2d 566 (La. 1983) 20

Ward v. Pennington, 523 So.2d 1286 (La. 1988) .. 20

ADMINISTRATIVE DECISIONS

Arizona Public Service Co., 23 FERC ¶ 61,419 (1983), *summarily aff'g*, 21 FERC ¶ 63,007 (1982) 19

Arizona Public Service Co., 27 FERC ¶ 61,185 (1984) 19

Middle South Energy, Inc., 31 FERC ¶ 61,305, aff'd, 32 FERC ¶ 61,425 (1985) 9

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Minnesota Power & Light Co., 11 FERC ¶ 61,312 (1980) 18

Table of Authorities Continued

	Page
New England Power Co., 8 FERC ¶ 61,054 (1979), *aff'd sub nom., NEPCO Municipal Rate Committee v. FERC*, 668 F.2d 1327 (D.C. Cir. 1981), *cert. denied*, 457 U.S. 1117 (1982)	18
New England Power Co., 32 FERC ¶ 61,112 (1985), *aff'd sub nom., Violet v. FERC*, 800 F.2d 280 (1st Cir. 1986)	18
New England Power Co., 42 FERC ¶ 61,016 (1988)	18
Northern States Power Co., 17 FERC ¶ 61,196 (1981), *aff'd sub nom., South Dakota Public Utilities Comm'n v. FERC*, 690 F.2d 674 (8th Cir. 1982)	18
Regulation of Electricity Sales-For-Resale and Transmission Service, FERC Statutes and Regulations, ¶ 35,518 (1985)	18
Southern California Edison Co., 8 FERC ¶ 61,198 (1979), *aff'd sub nom., Anaheim, Riverside, et al. v. FERC*, 669 F.2d 799 (D.C. Cir. 1981)	18
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STATUTES

28 U.S.C. § 1738	5,19
La. Code Civ. Proc. Ann. art. 531	5,19
La. Code Civ. Proc. Ann. art. 532	21
La. Code Civ. Proc. Ann. art. 1841	19
La. Civ. Code Ann. art. 3556(31)	19,20
Louisiana R.S. 13:4231	20
Council Ordinance No. 7068 of 1922	6
Section 201 of the Federal Power Act, 16 U.S.C. § 824	14,17

Table of Authorities Continued

	Page
MISCELLANEOUS	
Nuclear Regulatory Commission, Information Digest (1990)	21
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S. Rep. No. 621, 74th Cong., 1st Sess. (1935)	14
Wright & Miller, 18 Federal Practice and Procedure § 4433	21

IN THE

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OCTOBER TERM, 1990

No. 90-1156

NEW ORLEANS PUBLIC SERVICE INC.,
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v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*
Respondents.

On Petition For Writ Of Certiorari
To The United States Court of Appeals
For The Fifth Circuit

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION

STATEMENT OF THE CASE

A. *Introduction.* The "facial" preemption argument presented for review is so utterly lacking in substance that in order to advance it, petitioner[1] and its *amici* are forced to omit mention of the adverse and virtually dispositive language of the Court in its prior review of this matter, *NOPSI v. Council of New Orleans*, 491 U.S. 350, 109 S.

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[1] Proper names are abbreviated or defined in the same form as that employed in the petition. Petitioner is also referred to as "NOPSI." References to the Council's Order are in the form "R. Order."

Ct. 2506 (1989) ("*NOPSI III*").[2] There, the Court indicated that the Council's Order was not facially preempted, directly or indirectly, by any federal statute, regulation, or decision—including the *MP&L*[3] and *Nantahala*[4] cases, cited by the Court in the forepart of its opinion and upon which petitioner relies.

In *NOPSI III*, petitioner had explicitly embedded its "facial" preemption argument in its challenge to the district court's decision to abstain.[5] (Pet. Br., *NOPSI III*, at 35.) The Court responded that it was unnecessary to determine what result would be appropriate *if* it were confronted with an instance of clear facial preemption, because,

> The Council has *not* sought directly to regulate interstate wholesale rates; *nor* has it questioned the validity of the FERC-prescribed allocation of power within the Grand Gulf system, or the FERC-prescribed wholesale rates; *nor* has it reexamined the prudence of NOPSI's agreement to participate in Grand Gulf 1 in the first place. Rather, the Council maintains that it has examined the prudence of NOPSI's failure, after the risks of nuclear power became apparent, to diversify its supply portfolio, and that finding that failure negligent, it has taken the *normal rate-making step* of making NOPSI's shareholders rather than the ratepayers bear the consequences. *Nothing in this is directly or even indirectly foreclosed by the federal statute, the regulations implementing it, or the case law applying it.*

[2] In fact, the petition barely and only tangentially mentions *NOPSI III*. (*See* Pet. at 3, 7, 8 n.5, 9, 16.)

[3] *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988) ("*MP&L*"), *cited in* 109 S. Ct. at 2509.

[4] *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), *cited in* 109 S. Ct. at 2509.

[5] Petitioner's "Question Presented" in *NOPSI III* was whether abstention was appropriate where "a federal statute and the explicit orders of a federal agency (here FERC) have preempted local regulatory authorities" (Pet. Br., *NOPSI III*, at i). It asserted that the Council's Order was "invalid on its face." (*Id.* at 35.)

109 S. Ct. at 2517 (emphasis added). Continuing, the Court explained that the preemption issue in this case must inevitably be decided by a factual inquiry:

> There may well be reason to doubt the Council's necessary *factual* finding that NOPSI would have saved money had it diversified. See n. 2, *supra*. But we cannot conclusively say it is wrong *without further factual inquiry* . . . .

109 S. Ct. at 2517 (emphasis added). Similarly, the Court viewed NOPSI's so-called "pretext" claim (not presented for review here) as one requiring factual inquiry, as did the Fifth Circuit.[6] Petitioner simply seeks a second review here of an issue presented in *NOPSI III*, using the same arguments.

Further, the petitioner and the FERC's *amicus* brief employ the ruse of confusing those actions taken by the Council with *different* acts, not taken, that would have been preempted—a position also rejected in *NOPSI III*. Virtually all their arguments rely upon confusing: (1) the decisions of *intercompany* consequence to *undertake*, to *construct* and to *complete* the Grand Gulf 1 project, as well as the intercompany *allocation* of costs—all within the

[6] The Court stated that: "Analysis of this pretext claim requires an inquiry into industry practice, wholesale rates, and power availability during the relevant time period, an endeavor that demands some level of industry-specific expertise." *NOPSI III*, 109 S. Ct. at 2515. The Fifth Circuit stated that the claim "cannot succeed in the face of a determination that the stated reasons underlying the Council's order were sufficiently supported by the evidence." (App. at 3A.)

FERC's jurisdiction—*with* (2) the option available to NOPSI to reduce its risks (and protect its ratepayers) through off-system sales of power—an option that was entirely consistent with both the construction of the plant and the FERC's allocations to NOPSI, as noted in *NOPSI III*. The Council addressed *only* such a resale option, in the context of record evidence that petitioner's management had proposed such an option to the Council, but instead, negligently ignored critical information and bypassed the very opportunities for off-system sales that *it* had proposed. (R. Order at 10-11, 164-71.) Given supporting evidence the Council's determination is neither "directly or even indirectly foreclosed by federal" law. *NOPSI III*, 109 S. Ct. at 2517.

Petitioner's key arguments, (1) that *MP&L* established a "*per se*" rule requiring the passing on of all FERC-allocated costs without offset (Pet. at 2); and (2) that the FERC had exclusive jurisdiction over the very matter ruled on by the Council (Pet. at 17)—are irreconcilable with the quoted language of *NOPSI III*. Notably, petitioner claims *no* conflict between the decision below and *NOPSI III*. A distinguished panel of the Fifth Circuit made a conscientious effort to assess NOPSI's arguments in light of the Court's precedents and was keenly aware of what the Council did and did not do, as well as the boundaries drawn between federal and state regulatory action in *Nantahala*, *MP&L* and other cases. (App. 11A-18A.)

Petitioner adverts to state court and FERC cases (not one of which was cited in the two courts below) that deal entirely with other kinds of matters (primarily plant construction) in order to fabricate non-existent conflicts. (*See* Pet. at 13-16.) There is no arguable conflict, *see infra* at 18-19, and the FERC notably does not make a similar contention. Instead, the FERC's brief assists petitioner's effort by making obfuscatory assertions as to its own jurisdiction that cannot withstand examination. *See infra* at 15-17.

The procedural posture here also makes review inappropriate. Petitioner has raised virtually identical preemption challenges in the state and federal courts. Several months after the *NOPSI III* decision, the state trial court ruled that the Order was supported by the record evidence, and that there was no factual *or* facial basis for federal preemption. *NOPSI v. Council of New Orleans*, No. 88-4511, slip op. (La. Civ. Dist. Ct. Nov. 15, 1989).

Were the Court to grant review here, it could likely not proceed to the merits because the prior state court judgment was entitled to full "credit" in the federal courts, 28 U.S.C. § 1738, for the "conclusive" effect specifically accorded to it by Louisiana law, La. Code Civ. Proc. Ann. art. 531, as discussed *infra* at 19-21. Moreover, the state court judgment is on appeal, and it seems inappropriate for the Court now to re-review preemption as a "facial" issue, extracted from evidentiary context, on a duplicative track. NOPSI will shortly be in a position to seek review of its several preemption claims by the Court, and should await their proper development. Indeed, the usual course of review of a state utility regulatory order lies through the state court system, and the *MP&L* and *Nantahala* cases followed just that path.

Finally, this case in its present posture is of limited importance, turning on the application of well-articulated law to its particular facts. The effect of the decision below is merely to allow a state regulator to explore an issue factually, without broad, categorical "facial" preemption prohibitions.

Inasmuch as the petitioner omits or misstates significant portions of the factual record, there is a need to restate certain areas with some particularity, as follows.

B. *The Parties*. The Council is invested by law with "all powers of supervision, regulation and control over any" public utility operating in New Orleans. Section 4-1604, Home Rule Charter. Its regulatory power is rec-

ognized by the Louisiana Constitution of 1974. (R. Order at 1-2.)[7]

NOPSI retails electricity entirely in New Orleans. It is the smallest of the wholly-owned operating subsidiaries of Middle South Utilities, Inc. ("MSU") that provide retail electric service (the others being AP&L, LP&L and MP&L). Middle South Energy ("MSE," since renamed "SERI") is the MSU subsidiary created to own Grand Gulf. NOPSI's legal right to operate and to collect rates rests on the Council's authorizing it to do so. Council Ordinance No. 7068 of 1922.

C. ***The MSU "System".*** The petition misportrays the MSU "system" so as to understate each retail company's operating freedom. The MSU "system" is managed as an electric power pool in that the generating units are centrally dispatched and transmission facilities are interconnected. Further, decisions to build generation plants are based on all the companies' needs. However, each plant has been owned and operated by an individual operating company, except Grand Gulf, owned by MSE. The MSU system agreement requires that each company be individually responsible for meeting its own power needs through plant ownership or contracts for power (NOPSI Exh. 36, Item 1, at 14, § 4.01), and each company has independently bought and sold interests in particular plants. (*See* R. Order at 62-70.) As a result, the retail operating companies do not bear the system's total power or costs either equally or proportionately, and there have been significant cost disparities among the companies—despite the various "system agreements."[8] (R. Order at 68-69.) Petitioner had the

[7] Because the Order cites and catalogues the record evidence on which it relies, it is cited for convenience here as a reference to the evidence.

[8] The "system agreements" allocate responsibility for and "roughly equalize" excess capacity costs, but not the companies' *total* power costs. A company pays principally for the power it generates or buys. (R. Order at 63-71; 93-94.)

highest costs on the "system" for almost 20 years. (*Id.* at 69.)

D. ***Grand Gulf.*** Grand Gulf I, described as "catastrophically uneconomical,"[9] was placed in service in 1985 at a cost exceeding $3.6 billion, nearly six times the original projection.[10] Its origin dates to 1974, when NOPSI and other MSU companies agreed to guarantee its construction costs and to pay for indeterminate amounts of its future output (R. Order at 76-80). For six years, NOPSI did not inform the Council of its commitments. (*Id.* at 95 n.57.)

Certain significant events unfolded as construction of Grand Gulf progressed: *First*, other MSU operating companies, but not NOPSI, diversified their fuel sources through the acquisition of coal-fired generation. (R. Order at 80-83.) *Second*, the companies' projected need for additional generating capacity decreased. (*Id.* at 71-72.) *Third*, nuclear plant construction costs increased relentlessly, driven primarily by safety concerns and regulation. (*Id.* at 83-86; 132-142.)[11] *Fourth*, in March 1979 an accident of unprecedented nature occurred at the Three Mile Island nuclear plant ("TMI"), precipitating a major governmental inquiry and significant additional cost implications. (*Id.* at 87-88; 145-48.)

[9] *Mississippi Indus., Inc. v. FERC*, 808 F.2d 1525, 1528 (D.C. Cir.), *vacated in part*, 822 F.2d 1104 (D.C. Cir.), *cert. denied*, 484 U.S. 985 (1987).

[10] NOPSI's share, if passed through fully and immediately, would have resulted in a 60% increase in retail electric rates. (R. Order at 6-7.) The attendant "severe rate shock effect" threatened economic devastation. (*See* R. Order at 7 n.2; *NOPSI v. Council of New Orleans*, No. 85-3398, slip op. at 5 (E.D. La. Sept. 16, 1985), *aff'd*, 798 F.2d 858 (5th Cir. 1986), *modifying* 782 F.2d 1236, (5th Cir.), *cert. denied*, 481 U.S. 1023 (1987) ("*NOPSI I*")). That serious problem was addressed by a rate "phase-in" plan. (R. Order at 189-190.)

[11] The petition erroneously suggests that cost escalation was limited to "between 1980 and July 1985" (Pet. at 4), but between 1974 and 1979, Grand Gulf's forecasted cost had doubled. R. Order at 84.

Shortly after the TMI incident, with Grand Gulf posing increased risk, NOPSI took several inexplicable actions at odds with its interests. It committed to a 29.8% share of Grand Gulf—more than three times NOPSI's relative size in the system—which the FERC subsequently found to be unreasonably large. (*Id.* at 88-94.) Concurrently, NOPSI agreed that its politically powerful sister company, AP&L, need take no Grand Gulf power. In May 1980, NOPSI for the first time disclosed to the Council its Grand Gulf involvement and sought the Council's approval of an unusual "capacity adjustment clause" that would have authorized an automatic future rate increase for NOPSI's Grand Gulf costs, before their magnitude was actually known. It portrayed this proposal as speeding Grand Gulf "benefits" to the ratepayers (R. Order at 95).

Under critical examination at the Council hearing, NOPSI's president twice testified that NOPSI could sell its Grand Gulf power to other utilities, stating, "NOPSI has the option of selling the capacity and marketing it" (R. Order at 96); and later, "[W]e will have the option of selling . . . our portion of it to some other buyer." (*Id.*) The Council declined to approve the "capacity adjustment" proposal but took no further regulatory action given NOPSI's representations.

E. *The FERC Proceedings.* In 1982, MSE sought FERC approval of, *inter alia*, the MSU companies' allocations of Grand Gulf by filing two proceedings described in the petition at 5. Despite its large commitment, NOPSI did not participate until after the close of evidence; opposition to the allocations was carried entirely by intervenors. (R. Order at 97.) The prudence of the MSU companies' investing in, constructing or completing Grand Gulf was not raised. *MP&L*, 487 U.S. at 375. Further, one of the administrative judges declared that the proceeding would not intrude into state-regulated matters involving the responsibilities of the retail companies and declined to preclude state prudence reviews thereof. *Middle South Energy, Inc.*, FERC No. ER82-616-000, Tr. at 228, 248 (Mar. 14, 1983) (*see* R. Order at 46).

The FERC issued Opinion No. 234 (augmented in Opinion No. 234-A), rejecting the agreed allocations. *Middle South Energy, Inc.*, 31 FERC ¶ 61,305 at 61,655, *aff'd*, 32 FERC ¶ 61,425 (1985). It found that Grand Gulf had been planned jointly and that power planning was sufficiently coordinated so that all nuclear costs should be shared (31 FERC at 61,655-56); but it disclaimed holding that the system companies lacked independence (32 FERC at 61,953), and it held that other generation costs should not be shared. It developed an allocation formula, which reduced NOPSI's 29.8% share to 17% and LP&L's 38.5% share to 14%; allocated a new 36% share to AP&L;[12] and adjusted MP&L's share to 33%. *Id.* at 61,655. Wholesale rates followed from these allocations.

The FERC declined, on jurisdictional grounds, to direct how such costs should be recovered in retail rates (32 FERC at 61,952); did not bar retail-level inquiries (*NOPSI II*, Dist. Ct. slip op. at 7); and acknowledged the Congressionally-protected role of the states in retail rate regulation (32 FERC at 61,951) which, it declared, remained unchanged. (*Id.* at 61,952.)

F. *The Council's Ratemaking Proceedings.* In May 1985, NOPSI applied to the Council for a retail rate increase to reflect its Grand Gulf costs. (R. Order at 14.) The Council set rate proceedings in motion and, pending final determination, granted an interim rate increase and,

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[12] In prior briefs, petitioner has erroneously sought to assimilate AP&L's stance to the Order's determinations regarding NOPSI. AP&L, however, sought to escape any allocation, thus throwing larger allocations onto other MSU companies: and its stance conflicted with the FERC's allocation ruling. The Council's Order, however, had nothing to do with the allocation, but rather contemplated that NOPSI would remain responsible for its share and would have revenues from sales off-system (R. Order at 168).

later, entered into a partial settlement.[13] The prudence inquiry,[14] initiated as part of the proceedings, was conducted in three phases involving an extensive evidentiary record, transmitted to the Council on April 16, 1987. (*Id.*)

G. *The Rate Order and "NOPSI III".* The Council's decision, embodied in a 224 page Order issued February 4, 1988, did not question the FERC's allocation to NOPSI, nor base any remedy on the agreements to build, construct or complete Grand Gulf (R. Order at 10, 109; *NOPSI III*, 109 S. Ct. at 2517); nor did it shift any Grand Gulf costs to ratepayers elsewhere (R. Order at 41-43). Rather, it found, in summary, that NOPSI's management failed to exercise any critical oversight over its obligations; that in 1979-80, the economic prospects of Grand Gulf had become uncertain; that if management had acted responsibly, it would have arranged to resell a portion of NOPSI's share off-system as *it* had suggested; and that instead management publicly dissembled and took no action. In light of testimony that NOPSI should have sold all its share, but

[13] The FERC's recital here that the Council "refused to allow NOPSI to recover its Grand Gulf 1" costs and "denied NOPSI's request for interim rate relief" (FERC Br. at 4 and n.3) is simply erroneous. NOPSI *refused* to seek interim rate relief and sued the Council. The federal district court instead required NOPSI to seek interim relief (and found that the Council was acting in good faith). *NOPSI I*, Dist. Ct. slip op. at 11-12. The Council then granted interim relief and offered more. On March 20, 1986, a partial settlement was reached. Other MSU operating companies also reached settlements elsewhere involving rate deferrals and absorptions. (R. Order at 42 n.31.)

[14] A prudence inquiry involves an examination of a utility's actions to determine whether management acted capably and reasonably under the circumstances prevailing and under decisional standards. (R. Order at 31-41.) The established rule is that shareholders, not ratepayers, bear the costs of bad management. *See Missouri ex rel. Southwestern Bell Tel. Co. v. Pub. Serv. Comm'n*, 262 U.S. 276, 289 n.1 (1923) (Brandeis, J., concurring). NOPSI sought, unsuccessfully, to block the prudence inquiry. *Middle South Energy, Inc. and NOPSI v. Council of New Orleans*, No. 85-5273 (E.D. La. Dec. 19, 1986), *aff'd*, *NOPSI v. Council of New Orleans*, 833 F.2d 583 (5th Cir. 1987) ("*NOPSI II*").

in moderation, might have retained a 9% share, the Council considered the economic impact of any remedy, and it ultimately assessed NOPSI for a failure to sell about a 3% share.[15] (R. Order at 11-13; App. 8A.)

Suits were then filed in state and federal court. The federal district court abstained, and the Court of Appeals affirmed. In *NOPSI III* the Court found that the need to abstain ended with the issuance of the Order. (109 S. Ct. at 2520.)

H. *The State Court Proceedings*. The state court proceeding comprises three actions: (1) by the Council, seeking, *inter alia*, review of the order,[16] (2) by a citizens' group contesting the Order as too moderate,[17] and (3) by petitioner raising federal preemption and state law claims.[18]

On November 15, 1989, the state court upheld the Order, determining, *inter alia*, that "each of the findings . . . is rationally based and is supported by substantial evidence" (slip op. at 6). Petitioner's appeal therefrom is *sub judice*. *NOPSI v. Council of New Orleans*, No. 90-CA-0420 (La. Ct. App. 4th Cir.). Petitioner's claim that its appeal is "limited" to state law issues (Pet. at 11) is simply in-

[15] The original Fifth Circuit opinion noted that 14% was effectively included in NOPSI's retail rates, but incorrectly described this as equal to "the amount the Council had argued NOPSI should bear in the FERC proceedings." (App. 8A.) The court issued a corrected opinion, lodged with the Clerk of this Court. The petition's suggestion that the Order achieved the result that New Orleans had sought in the FERC proceeding (Pet. at 7) is incorrect.

[16] *Boissiere v. NOPSI*, No. 88-2503 (La. Civ. Dist. Ct. filed Feb. 4, 1988).

[17] *Alliance for Affordable Energy, Inc. v. Council of New Orleans*, No. 88-2502 (La. Civ. Dist. Ct. filed Feb. 4, 1988).

[18] *NOPSI v. Council of New Orleans*, No. 88-4511 (La. Civ. Dist. Ct. filed Mar. 7, 1988).

accurate, as its facial preemption claim is presented there.[19] To the extent petitioner has chosen to deemphasize its "facial" claim, it may be because every court, state and federal, that had considered it has held it to be meritless.[20]

REASONS FOR DENYING THE PETITION

1. The Petitioner Simply Misportrays The Facts Here, And Those In Other Cases, As It Did In *NOPSI III*

This is the second time that petitioner has sought to prevail primarily by the expedient of misportraying the prudence Order. The Order did not challenge the agreement for, or the construction[21] of, Grand Gulf, nor the FERC-allocated share of power. Rather it found that NOPSI should have undertaken the very sales that its management proposed. (R. Order at 164-171.) Given such sales, NOPSI's allocation and costs would have remained undisturbed, but there would have been offsetting revenues to reduce rates. (R. Order at 168.) In assessing the Order,

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[19] Appellant's Br. at 42-64, 67; Appellant's Reply Br. at 10-17, 22, *NOPSI v. Council of New Orleans*, No. 90-CA-0420 (La. Ct. App. 4th Cir.).

[20] Petitioner contends that the decision below will act as *res judicata* in the *state* court proceeding (Pet. at 10), which is inverted at best, since the state court proceeding was commenced, and ruled upon the preemption claims, first. *See infra* at 19-21.

[21] It is important to underscore that a decision to complete a plant is *not* the same as a decision by a buyer to retain (or to resell) all of one's right to power from that plant. By simple analogy, an office building may be completed rather than left an incomplete shell on the expectation that it may be economic at some time. (The decision involves weighing the "to-go" costs of completion against those of abandonment.) At the same time, a party obligated to take space in it may sublease all or part of its share, according to its needs. Here, the FERC was concerned with the proper allocation of responsibility for Grand Gulf among the participants; it has *never* asserted any interest in blocking further sales of power by the retail companies.

which comprised part of the record in *NOPSI III*, the Court stated that the actions reflected therein were not "directly or even indirectly foreclosed" by federal law, 109 S. Ct. at 2517, and that its merit depended upon the evidentiary record. *Id.*

Plainly, the types of matters that are within the FERC's jurisdiction--*i.e.*, (1) the allocation of costs among the companies (the focus in *Nantahala*); and (2) the merits of the interstate agreements and decisions to participate in, and to build the plant (the foci in *MP&L*)—were not bases for the Council's action. That the petition ignores these distinctions is illustrated by its claim that the panel below ruled that a state has jurisdiction to determine whether a retail company acted prudently "while construction of the wholesale plant was 'under way' " (Pet. at 2)—thus implying that the state could act on *all* matters during that period—and thus misportraying Judge Higgenbotham's reference to the *time* of the operative events as if it stated the *basis* for the Court's decision. The Fifth Circuit had the Order before it, stated its agreement with this Court's analysis of the Order (App. at 15A), conscientiously examined the Court's precedents in *MP&L*, *Nantahala*, *NOPSI III*, and other cases and correctly applied them to the particular circumstances here.

The petition's contention that the decision here "squarely conflicts" with *MP&L* and *Nantahala* (Pet. at 11) is untenable. *Nantahala* involved a state's attempt to substitute its own interstate *allocation* of power costs for the FERC's in setting local retail rates. 476 U.S. at 968-69. *MP&L* involved a state's much belated attempt to hold a prudence inquiry (and require the return of two years' rates) to determine (1) whether MP&L and the interstate group of utilities "acted reasonably when they constructed Grand Gulf 1," 487 U.S. at 368, and (2) to the end that MP&L might be deemed "obligated to purchase less Grand Gulf power than" the FERC allocated, *id.* at 373, thus invading two areas (construction and allocation) within the FERC's

jurisdiction. This Court and every other court examining this matter have recognized the different concerns addressed by these cases[22] and have concluded, as did the court below, that there is "no merit in NOPSI's facial preemption challenge." App. at 24A.

The petition's assertion of disharmony here with the supposed policy of the Federal Power Act ("FPA")—misstated as that of restraining "uncontrolled" state regulation that would "interfere with broader national interests"— is equally untenable. (Pet. at 12.) The purpose of the FPA was to maintain a *dual* system of regulation. One of Congress' principal concerns was to *protect* state regulation of retail matters at the same time that it created a federal agency to regulate interstate matters—the states having been held lacking in power to do so. *See Federal Power Comm'n v. Southern Cal. Edison Co.*, 376 U.S. 205, 211 (1964). Thus, Section 201 of the FPA, 16 U.S.C. § 824(a), limits federal regulation "to those matters not subject to regulation by the States," and denies FERC jurisdiction "over facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce." 16 U.S.C. § 824(b)(1). The final bill:

> [*R*]*emoved every encroachment upon the authority of the States.* The revised bill would impose Federal regulation *only over those matters which cannot effectively be controlled by the States.* The limitation on the Federal Power Commission's jurisdiction . . . has been inserted . . . in an *effort to prevent the expansion of Federal authority over State matters.*

S. Rep. No. 621, 74th Cong., 1st Sess. 18 (1935) (emphasis added). The Court has noted:

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[22] App. 16A-18A, 27A; *NOPSI v. Council of New Orleans*, No. 88-4511, slip op. at 5-6.

> The Act . . . had *no purpose or effect to cut down state power.* On the contrary, perhaps its primary purpose was to *aid in making state regulation effective* . . . .

Panhandle Eastern Pipeline Co. v. Public Serv. Comm'n of Indiana, 332 U.S. 507, 517 (1947) (emphasis added).

The legislative history could hardly be more contrary to petitioner's position, and it also affects the preemption analysis. Since Congress did not intend to preempt state utility regulation, but to protect it against encroachment, it is obligatory to conduct a factual "conflict-pre-emption analysis" which,

> must be applied sensitively in this area, so as to prevent the diminution of the role Congress reserved to the States while at the same time preserving the federal role.

Northwest Cent. Pipeline Corp. v. State Corp. Comm'n, 489 U.S. 493, 515 (1989). The idea that the Court should intervene now to resolve the preemption issue on a "facial" basis is contrary not only to its position in *NOPSI III*, but to the Court's *Northwest Central Pipeline* test as well.

2. The Decision Below Leaves the FERC's Jurisdiction Fully Intact

Hidden beneath the indistinct language of petitioner's complaint that the decision below erroneously failed to grant the FERC exclusive jurisdiction "to determine utility prudence during the construction of a wholesale generating facility" (Pet. at 11-12) lies the issue of *which* utility's prudence and *which* matter petitioner addresses. The Council addressed only NOPSI's prudence as to a power resale matter. Not even the FERC has contended here that it had jurisdiction to determine the matter of NOPSI's negligence for bypassing resale opportunities, but it has been drawn into making obfuscatory claims that make it seem so. It asserts:

1. "[O]nly FERC can properly and fairly resolve . . . how the benefits and burdens . . . should be shared between affiliated companies. . . . " (FERC Br. at 12.) However, the Council's Order does *not* address such sharing of benefits or burdens, but rather leaves the FERC's determination intact, as the Court noted in *NOPSI III*, 109 S. Ct. at 2517.

2. "FERC had jurisdiction to consider the argument that Grand Gulf 1 costs were imprudently incurred and should not be passed through to operating utilities . . . . " (FERC Br. at 12.) However, the Council did *not* determine that NOPSI imprudently incurred any Grand Gulf costs, much less by reason of the intercompany agreements, the construction or the allocation. The Order confined itself instead to NOPSI's neglect of the cost-offsetting transactions it had suggested, as recognized in *NOPSI III*. 109 S. Ct. at 2517.

3. "FERC did consider the prudence issue in determining the appropriate allocation of the capacity and costs of Grand Gulf 1 among the four operating companies" (FERC Br. at 14, n.16.) But even this materially inaccurate claim does not suggest that FERC considered NOPSI's prudence in respect to the off-system sales (nor could it, as noted *infra*). The panel below was clearly aware of what the FERC did and did not do in the area of prudence. (App. at 6A.)

Making similar assertions regarding the Fifth Circuit's jurisdictional findings, the FERC states that the Council "has no jurisdiction to decide that NOPSI imprudently *participated* in the Grand Gulf 1 project" (FERC Br. at 12) and " 'cannot evaluate * * * the prudence of [NOPSI's] *decision to be a party to agreements* to construct and operate Grand Gulf . . . . " (FERC Br. at 15 (emphasis added).) However, this Court noted that the Council simply did *not* act as the FERC describes; it has not "reexamined

the prudence of NOPSI's agreement to participate in Grand Gulf 1." 109 S. Ct. at 2517. *See* App. 15A.

The FERC did not consider the type of matter determined by the Council and deemed it not within "the scope of issues considered in reviewing the rates and terms for the jurisdictional sale of power."[23] It avoided all other state-level issues on jurisdictional grounds. *See Middle South Serv., Inc.*, 30 FERC ¶ 63,030, at 65,151 (1985). Indeed, management's failure to pursue off-system sales could not even have been raised at the FERC, which has jurisdiction to review only an interstate transaction *actually filed* with it for approval. *See* 16 U.S.C. § 824e. Where, as here, the utility negligently *failed* to engage in a transaction, there would be no transaction or rate to file at the FERC to establish its jurisdiction (much less to justify an unprecedented retail inquiry). Were no state-level review possible here, NOPSI would escape regulation entirely.

Finally, NOPSI's contention that certain "subsidiary findings" of the Council are inconsistent with "explicit" FERC determinations (Pet. at 7) is not only erroneous and irrelevant, but was raised previously in *NOPSI III* (although not endorsed by the FERC), where petitioner argued that the Council was "making findings that conflict with the very determinations made by FERC." Pet. Br., *NOPSI III*, at 37. The argument was rejected there, and

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[23] After issuing its opinions, the FERC filed testimony in the Congress stating that it had not in fact considered the individual responsibilities of the MSU operating companies because the proceeding "was not one in which the operating utilities attempted to pass-through the actual costs," and that in such a proceeding, "the *prudence* of a party as the *purchaser* . . . is *not* generally within the scope of the issues considered in reviewing the rates and terms for the jurisdictional *sale* of power." *Powerplant Costs: Hearing Before the Subcomm. on Energy Conservation and Power of the House Comm. on Energy and Commerce*, 99th Cong., 2d Sess. 29, 21 (1986) (statement of Acting Chairman, FERC) (emphasis in original and added).

by all courts since. In making the same argument now, the petition contains a lengthy footnote that misstates and mismatches findings of the Council and the FERC. (Pet. at 7 n.5.) Consideration of these matters requires familiarity with facts underlying the determinations, and the argument can hardly be said to suggest "facial" preemption.

3. There Are No Decisions In Conflict With The Ruling Below

Not *one* of the decisions offered by petitioner is even arguably in conflict with the ruling below (Pet. at 18 n.17). They involve, without exception, FERC determinations as to whether a utility seeking approval of a wholesale rate properly completed or abandoned *construction* of a particular plant, or part of one.[24] One case also involves the propriety of the initial agreement to undertake construction responsibility.[25] The decisions have *nothing* to do with whether a buyer of power—such as petitioner—had the opportunity to sell a portion elsewhere. One remaining case cited as purporting to show that FERC can review a utility's "keeping" or "selling" a plant, merely involved

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[24] *See New England Power Co.*, 8 FERC ¶ 61,054 (1979) (plant cancellation), *aff'd sub nom., NEPCO Municipal Rate Committee v. FERC*, 668 F.2d 1327 (D.C. Cir. 1981), *cert. denied*, 457 U.S. 1117 (1982); *Southern California Edison Co.*, 8 FERC ¶ 61,198 (1979) (plant cancellation), *aff'd sub nom., Anaheim, Riverside et al. v. FERC*, 669 F.2d 799 (D.C. Cir. 1981); *Minnesota Power & Light Co.*, 11 FERC ¶ 61,312 (1980) (retirement of pollution control device); *Northern States Power Co.*, 17 FERC ¶ 61,196 (1981) (plant cancellation), *aff'd sub nom., South Dakota Public Utilities Comm'n v. FERC*, 690 F.2d 674 (8th Cir. 1982); *New England Power Co.*, 32 FERC ¶ 61,112 (1985) (plant cancellation), *aff'd sub nom., Violet v. FERC*, 800 F.2d 280 (1st Cir. 1986); *Union Electric Co.*, 40 FERC ¶ 61,046 (1987) (plant construction); *New England Power Co.*, 42 FERC ¶ 61,016 (1988) (plant cancellation). *See also Regulation of Electricity Sales-For-Resale and Transmission Service*, FERC Statutes and Regulations, ¶ 35,518 (1985).

[25] *New England Power Co.*, 32 FERC ¶ 61,112 (1985), *aff'd sub nom., Violet v. FERC*, 800 F.2d 280 (1st Cir. 1986).

the determination, as in the cases above, of whether "continued construction" of a plant was proper.[26]

The state court cases on which petitioner relies are even less pertinent. Each merely accepts, as they must and as the Council did, a FERC-established wholesale rate as the basis for retail rates.[27]

4. No Review Should Be Undertaken Here In Light Of The Prior State Court Judgment

Review on the merits here would be curtailed by a state law issue. Section 1738 of 28 U.S.C. requires a federal court to give a prior state court decision "the same full faith and credit" it has "by law or usage in the courts of" the state. The "credit" that Louisiana gives to a *trial* court judgment is that it "shall be conclusive of all" suits between the parties on the same cause of action. La. Code Civ. Proc. Ann. art. 531.[28] Even if two actions proceed, the "first final judgment rendered" becomes "conclusive of all." A "final judgment" is one at trial level "that determines the merits in whole or in part." La. Code Civ. Proc. Ann. art. 1841.

The Fifth Circuit believed that it could proceed with the case because the state court judgment was not definition-

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[26] *Arizona Public Service Co.*, 27 FERC ¶ 61,185, at 61,351 (1984); *Arizona Public Service Co.*, 23 FERC ¶ 61,419 (1983), *summarily aff'g*, 21 FERC ¶ 63,007 (1982).

[27] *Eastern Edison Co. v. Department of Public Utilities*, 446 N.E.2d 684 (Mass. 1983), involved a FERC-determined rate that reflected recoupment of the wholesaler's investment in an abandoned plant; *Northern States Power Co. v. Hagen*, 314 N.W.2d 32, 38 (N.D. 1981), involved a FERC-determined rate allocating between two utilities the cost of an abandoned plant; and *Northern States Power Co. v. Minnesota Public Utilities Comm'n*, 344 N.W.2d 374 (1984), *cert. denied*, 467 U.S. 1256 (1984), involved the same issue.

[28] La. Code Civ. Proc. Ann. art. 531 is set forth as an appendix hereto.

ally within La. Civ. Code Ann. art. 3556(31) (App. at 23A.), which defines "thing adjudged" as a matter from which "there can be no appeal". But the section does not purport to detract from the "conclusive" effect given by Article 531. Indeed, the Louisiana court decisions that refer to Section 3556(31) as stating that "res judicata" requires that the appellate process be concluded[29] all involve *completed* appellate processes, and they do not address the effect of a trial court judgment.

Such conclusive effect was reaffirmed during the passage of a new "res judicata" statute, Louisiana R.S. 13:4231, effective January 1, 1991. It provides, *inter alia*, that "a valid and final judgment is conclusive between the same parties, except on appeal or other direct review." The official comment makes clear that the *prior* law gave *conclusive* effect to a trial court judgment[30]:

> The use of the phrase "final judgment" also means that the preclusive effect of a judgment attaches once a final judgment has been signed by the trial court. . . . [This] is *in accord with our present law* on lis pendens, see Code of Civil Procedure Articles 531, 532.[31]

[29] *McConnell v. Travelers Indemnity Co.*, 346 F.2d 219, 223 (5th Cir. 1965); *Ward v. Pennington*, 523 So.2d 1286, 1290 (La. 1988); *Mente & Co. v. Anciens Etablissements Verdier-Dufour & Cie.*, 149 So. 492, 493 (La. 1933); *Hospital Corp. of America v. Robinson*, 506 So.2d 938, 940 (La. App. 1987); *Coleman v. Comm'n on Ethics for Public Employees*, 439 So.2d 451, 453 (La. App. 1983); *Thomas v. Dept. of Corrections*, 430 So.2d 1153, 1155 (La. App.), *cert. denied*, 435 So.2d 432 and 438 So.2d 566 (La. 1983).

[30] This effectively leaves the case in a condition discussed during oral argument of *NOPSI III*, Transcript pp. 24-25:

> SOLICITOR: If the state court beat the federal court to the issue, then we might have a res judicata problem . . . .
>
> THE COURT: A rather severe one, wouldn't we?

La. R.S. Ann. 13:4231, Comment (d) (West 1991 Supp.) (emphasis added). Thus, 28 U.S.C. § 1738 requires that the Louisiana judgment receive preclusive effect here.[32]

5. There Is No Significant Issue Meriting Review.

The Court has already given guidance here in *NOPSI III* and will have the further opportunity for review after the case is fully developed. There is no conflict between courts, nor variance from the path outlined by this Court. The case will turn on its particular facts. Thus, assertions that the case has broad implications elsewhere are, at best, uninformed. Further, the evidence here shows a utility management that was indifferent to its responsibilities and that ignored the very opportunities that it had proposed. Any effect of the Order on other utilities will be only to encourage them to pursue available options conscientiously to determine their merit, and this is hardly a cause for concern. The effect of the decision below is only to allow state regulators to explore such a matter factually and within jurisdictional bounds, without broad, categorical "facial" preemption prohibitions.

Moreover, the issue of nuclear plant cost excesses and pass-throughs is largely disappearing. Most plants are complete (112 plants are completed, and only 3 remain scheduled for completion[33]). Petitioner's claim here, that it could sit on its hands, not take protective steps, not test the

[31] The majority rule in state and federal courts is that a judgment operates preclusively regardless of whether it is pending appeal. Wright & Miller, 18 Federal Practice and Procedure § 4433, at 308.

[32] Below, NOPSI erroneously contended that actions pending in federal courts were governed by a different statute, La. Code Civ. Proc. Ann. art. 532. That Section applies only when a prior *federal* action requires the state to stay its hand.

[33] Nuclear Regulatory Commission, Information Digest at 17 (1990).

market, and then escape with impunity, is and should be, of historical interest only.

CONCLUSION

For the reasons stated, the petition should be denied.

Respectfully submitted,

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March 25, 1991

APPENDIX

APPENDIX

LOUISIANA STATUTES

La. Code Civ. Proc. Ann. art. 531 (West 1960):

> When two or more suits are pending in a Louisiana court or courts on the same cause of action, between the same parties in the same capacities, and having the same object, the defendant may have all but the first suit dismissed by excepting thereto as provided in Aticle 925. When the defendant does not so except, the plaintiff may continue the prosecution of any of the suits, but the first final judgment rendered shall be conclusive of all.

Article 531 was amended effective January 1, 1991, in a manner not relevant here, as follows:

La. Code Civ. Proc. Ann. art. 531 (West Supp. 1991):

> When two or more suits are pending in a Louisiana court or courts on the same transaction or occurrence, between the same parties in the same capacities, the defendant may have all but the first suit dismissed by excepting thereto as provided in Article 925. When the defendant does not so except, the plaintiff may continue the prosecution of any of the suits, but the first final judgment rendered shall be conclusive of all.

(5)

No. 90-1156

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, JOSEPH I. GIARRUSSO, LAMBERT C. BOISSIERE, JR., MICHAEL EARLY, JAMES SINGLETON, DOROTHY MAE TAYLOR, JOHNNY JACKSON, and PEGGY WILSON,
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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PETITIONER'S REPLY TO COUNCIL'S BRIEF IN OPPOSITION TO PETITION

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	i
I. The Council's Order Is Facially Preempted Under *MP&L* and *Nantahala*	2
II. The Court's Earlier Abstention Holding Has No Pertinence To These Issues	5
III. The Council's Remaining Attempts To Avoid Review Are Meritless	6
CONCLUSION	8

TABLE OF AUTHORITIES

Cases:

Appalachian Power Co. v. *Public Serv. Comm'n of West Virginia*, 812 F.2d 898 (4th Cir. 1987)	7
Arkansas Louisiana Gas Co. v. *Hall*, 453 U.S. 571 (1981)	5
Chicago & N.W. Transp. Co. v. *Kalo Brick & Tile Co.*, 450 U.S. 311 (1981)	4
Kentucky Power Co. v. *Kentucky Pub. Serv. Comm'n*, No. 86-CA-1031-MR (Kentucky Ct. of Appeals, June 2, 1988)	7
Mississippi Power & Light Co. v. *Mississippi ex rel. Moore*, 487 U.S. 354 (1988)	*passim*
Nantahala Power & Light Co. v. *Thornburg*, 476 U.S. 953 (1986)	*passim*
NOPSI v. *Council of New Orleans*, 109 S. Ct. 2506 (1989)	5, 6
Younger v. *Harris*, 401 U.S. 37 (1971)	6

Administrative Decisions:

Middle South Energy, 26 FERC ¶ 63,044 (1984)	4
Middle South Energy, 31 FERC ¶ 61,305 (1985)	3, 4

Statutes:

28 U.S.C. § 1738	7
La. Acts 1990, No. 521	7
La. Civ. Code art. 3556(31)	7
La. Code Civ. Proc. art. 531	7
La. Code Civ. Proc. art. 532	8

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NEW ORLEANS PUBLIC SERVICE INC.,
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v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*,
Respondents.

PETITIONER'S REPLY TO COUNCIL'S BRIEF IN OPPOSITION TO PETITION [1]

The Council's Opposition ("Opp.") is an elaborate attempt to obscure the facts that have led FERC and the Solicitor General's Office [2] and the electric industry [3] to urge the Court to review, and reverse, the Fifth Circuit's decision in this case. But the Council's rhetoric and misstatements cannot obscure (1) the square conflict with *MP&L*, *Nantahala*, and numerous other prior preemption decisions,[4] (2) the irrelevance of the Court's prior abstention decision, or (3) the profound importance of a resolution of the conflicts in this case.

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[1] The Rule 29.1 Statement appears at p. ii of the Petition.

[2] *See* Brief for United States and FERC As Amici Curiae Supporting Petitioner (February, 1991).

[3] *See* Brief for Edison Electric Institute As Amicus Curiae Supporting Petitioner (February, 1991).

[4] *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, 487 U.S. 354 (1988); *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986); *see* Pet. 13 & n.10 & 17-20.

I. The Council's Order Is Facially Preempted Under *MP&L* and *Nantahala*.

First, the Opposition admits the facts that establish the square conflict with this Court's holdings in *MP&L* and *Nantahala*. The Council concedes that it has barred NOPSI from passing through to its retail customers—and thus "trapped"—$135 million of the Grand Gulf expenses that FERC ordered NOPSI to incur. Opp. 10-11. *Nantahala* prohibits this "trapping" of costs. It holds that "a state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price." *Nantahala*, 476 U.S. at 965. *MP&L* applied this principle to the very Grand Gulf costs at issue. It holds that a retail ratemaking body "may not enter an order 'trapping' the costs [MSU operating companies are] mandated to pay under the FERC order allocating Grand Gulf power or [even] *undertake a 'prudence' review for the purpose of deciding whether to enter such an order.*" *MP&L*, 487 U.S. at 372 (emphasis added).

In short, *MP&L* and *Nantahala* held that such state prudence disallowances *are* "categorical[ly]" and "facial[ly]" preempted. *Compare* Opp. 4 & 12-14. *MP&L* and *Nantahala* so held because they recognized that FERC has exclusive jurisdiction to decide—and "easily could" decide—any and all claims that a "prudent" utility could or would have otherwise reduced the wholesale costs FERC ordered it to incur. *MP&L*, 487 U.S. at 375; *id.* at 378-83 (Scalia, J., concurring). Indeed, because the Council filed an *amicus* brief in *MP&L* that unsuccessfully argued against this Court's outright reversal by raising the same arguments the Council now advances, it could not be clearer that *MP&L* forecloses the Council's claims. *See* Pet. 15 n.11.

The attempts to distinguish *MP&L* and *Nantahala* are futile. Indeed, even the Council recognizes that *MP&L* and numerous state and federal decisions reject the ground for the Fifth Circuit's judgment: its holding that it is the states, and not FERC, that have jurisdiction to

determine whether utilities "acted imprudently" in failing to "minimize their losses" while construction of a wholesale plant is "underway." *Compare* Opp. 13 & 18-19, *with* Pet. 12-20.

However, the Council makes an alternative argument that is, if anything, even less tenable. Opp. 15-17. It claims that the Federal Power Act recognizes a distinction between (1) determining a utility system's prudence in undertaking, constructing, and completing a plant and allocating the costs among individual participating utilities—which are matters for FERC—and (2) determining if an individual utility could have and prudently should have reduced its wholesale costs by entering into "off-system" sales of higher cost power and "off-system" purchases of lower cost power from "alternative power sources"—which, the Council claims, are matters for the states.

This is nonsense. The terms of the Act permit no such distinction, for it gives FERC exclusive jurisdiction to assure that all aspects of purchases and sales of power "for resale" are "just and reasonable." Moreover, the matter clearly falls within the scope of FERC's discretion, as FERC itself has clarified in its brief. FERC having found it "just and reasonable" for NOPSI to *obtain* 17% of Grand Gulf power, NOPSI cannot have been imprudent to *retain* that power "for resale" to retail customers, rather than simultaneously to sell it off.

Indeed, the facts of this case demonstrate that the Council's proposed distinction would permit the wholesale subversion of FERC's regulation. Here, FERC found that the MSU System's construction and completion of Grand Gulf were part of a reasonable system plan to diversify fuel sources.[5] Indeed, FERC specifically found that NOPSI and the other MSU companies acted prudently in 1980 when they decided to continue construction of the plant because it then appeared that Grand Gulf would "produce power for a total cost (capacity and

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[5] *Middle South Energy*, 31 FERC ¶ 61,305, p. 61,653-55 (1985).

energy) *which would be less than existing alternatives on the system,*" including coal-fired alternatives.[6]

However, in disallowing $135 million of FERC-mandated costs, the Council found precisely the opposite: that it was clear in 1980 that the Grand Gulf power would be far more expensive than alternative coal-fired power and that a "prudent" NOPSI could have and should have sold its then-contingent share (to a hypothetical "sucker" utility) and purchased equivalent amounts of lower cost coal power instead. In particular, the Council's theory is that FERC can determine that Grand Gulf represented prudent planning for the MSU system as a whole, but that the five different state and local rate-making bodies can revisit this issue and find, based on "local conditions," that individual MSU operating companies should have second-guessed the system's planning process, anticipated FERC's allocation, and sought to nullify both.[7]

Against this background, it could not be clearer that, whatever its label, the Council's finding that it was imprudent for NOPSI to retain its Grand Gulf interest is nothing more than an attack on FERC's explicit contrary determinations. In this regard, it is elementary that the preemptive effect of a FERC Order cannot be evaded through such "artful pleading" (*Chicago & N.W. Transp. Co.* v. *Kalo Brick & Tile Co.*, 450 U.S. 311, 324 (1981)) and that state action is preempted when, as here, it has the "effect of 'trapping'" FERC-mandated costs. *MP&L*, 487 U.S. at 372 n.12.

Finally, the Council's proposed distinction is particularly spurious for one additional reason. By deciding

[6] *Middle South Energy*, 26 FERC ¶ 63,044, pp. 65,112-65,113 (1984) (emphasis added), *aff'd* 31 FERC ¶ 61,305, pp. 61,655 & 61,666 (1985).

[7] It is thus no coincidence that the Council's formula reallocates the Grand Gulf percentages previously allocated by FERC and assigns to New Orleans the same 9% that the Council for years unsuccessfully urged before FERC.

that NOPSI could have reduced its wholesale costs by engaging in hypothetical wholesale sales and purchases of power that are within FERC's jurisdiction—and that the putative "benefits" would not be shared by other MSU operating companies—the Council has determined matters that are at the very heart of FERC's jurisdiction.[8] This epitomizes the "speculation" about FERC's decisions that the "filed rate doctrine forbids." *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 579 (1981).

II. The Court's Earlier Abstention Holding Has No Pertinence To These Issues.

Because *MP&L*, *Nantahala*, and their precursors are so clearly controlling, the Council devotes virtually its entire Opposition to assertions that this Court's earlier *abstention* decision in this case (*"NOPSI III"*) somehow rejected NOPSI's "facial" *preemption* claim and overruled *MP&L* and *Nantahala sub silentio.*

Plainly, only the Court is in a position to know what it meant in the passage from *NOPSI III* that the Council repeatedly cites. *See, e.g.*, Opp. 2-3, quoting 109 S. Ct.

[8] The Council's Order assumes both (1) that FERC would have allowed the hypothesized wholesale sales and purchases in 1980, and (2) that FERC would have allocated the hypothesized cost savings to NOPSI. The latter assumption, in particular, is contradicted by FERC's treatment of AP&L (which was allocated its pro rata share of Grand Gulf and denied the cost savings that resulted from its purchases of coal capacity and its success in contracting away all its Grand Gulf obligation). In any event, the Council's assumption constitutes "precisely what the filed rate doctrine [and settled pre-emption principles] forbid[]." *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 579 (1981). "[I]t amounts to nothing less than the award of a retroactive rate [reduction] based on *speculation* about what the Commission might have done had it been faced with the facts of this case." *Id.* at 578-79 (emphasis added).

The Council's sole response to all these points is to argue (Opp. 15-18) that FERC could not have considered these issues because the transactions in question are hypothetical, not real. But *all* the prudence claims that FERC (and other regulatory agencies) address involve hypothetical questions whether utilities could have and should have behaved differently. Here, these questions pertain to matters that are within FERC's exclusive jurisdiction.

2506, 2517 (1989). However, as the Fifth Circuit held (App. 9A-10A), there is nothing in the Court's Opinion that remotely suggests that it was overruling *MP&L* and *Nantahala* without saying so and without even discussing the holdings of those cases. To the contrary, the Court held that the lower court had erred in refusing to decide NOPSI's facial preemption claim (109 S. Ct. at 2515, 2520) and the Court stated it would not address the merits of that claim (109 S. Ct. at 2509-10).

Indeed, the Court was addressing a very different issue in the language the Council quotes: NOPSI's claim that this case fell within the "exception" to the *Younger* doctrine for challenges to state laws that are "flagrantly and patently violative of express constitutional prohibitions in every clause, sentence, and paragraph." *Younger* v. *Harris*, 401 U.S. 37, 53 (1971). All the Court held in *NOPSI III* was that if this exception exists, it must be a narrow one and would not be applied to a state rate-making order that did not purport to set wholesale rates or directly or indirectly to challenge a FERC order—as the Council's Order concededly does not. 109 S. Ct. at 2517. This holding, by its terms, has pertinence only to the abstention issue then before the Court, and has nothing to do with the merits of NOPSI's preemption claims —as the Fifth Circuit held.

III. The Council's Remaining Attempts To Avoid Review Are Meritless.

The Council's two remaining attempts to avoid review are spurious. First, it seeks to minimize the importance of this case by claiming that the federal preemption issues are of "historical interest only" and will not arise often in the future. Opp. 21-22. However, FERC, the Solicitor General's Office, and the electric industry have concluded precisely the opposite in urging the Court to review the Fifth Circuit decision. They recognize that, unless reversed, the Fifth Circuit's holding will lead states to act on their potent incentives to further their parochial interests and to thwart FERC's regulation of inter-

state power supply arrangements—as they have attempted to do in a vast array of circumstances.[9]

Finally, the Council argues that NOPSI is precluded from litigating its federal preemption claims in this case, and must await a final decision in the pending state proceedings before it may seek review in this Court. Opp. 19-21. This is a reprise of a Louisiana state law claim that both lower courts rejected: that an earlier state court trial decision is *res judicata* under Louisiana law and is thus entitled to full faith and credit under 28 U.S.C. § 1738 in this case. As the Fifth Circuit held (App. 23a), the Council's argument is "contrary" to the Louisiana statute that provides that a "final judgment" of a Louisiana court does not become *res judicata* ("the thing adjudged") until "there can be no [further] appeal." [10]

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[9] As FERC and the industry recognize, it is irrelevant that "most" nuclear "plants are complete." *Compare* Opp. 21. First, state attempts to impair FERC's jurisdiction over wholesale rates have not been confined to nuclear plants, but have repeatedly arisen in the cases of transmission agreements, power pooling arrangements, and coal-fired, hydroelectric, gas-fired, and oil-fired plants, as well as nuclear plants. *See, e.g., Appalachian Power Co.* v. *Public Serv. Comm'n of West Virginia*, 812 F.2d 898 (4th Cir. 1987) (transmission agreement); *Kentucky Power Co.* v. *Kentucky Pub. Serv. Comm'n*, No. 86-CA-1031-MR (Kentucky Ct. of Appeals, June 2, 1988) (coal plant). *See also Nantahala, supra* (hydroelectric plant). Further, the completion of "most" nuclear plants does not eliminate the issue of the "pass-through" of wholesale costs for even these plants, for they typically have useful lives of 30 years and more.

[10] La. Civ. Code art. 3556(31). Incredibly, the Council bases its contrary claims on the intervening Louisiana legislation that is designed to change the law of *res judicata* so that future Louisiana state trial judgments will have preclusive effect while pending on appeal. Acts 1990, No. 521, § 1. However, the Council does not inform the Court that the new statute only applies to cases brought *"on or after January 1, 1991," (id.,* § 5) and that the earlier statute continues to determine what preclusive effect the state court trial judgment in this case is to be given in federal courts under 28 U.S.C. § 1738. Similarly, the *lis pendens* statute that the Council cites (La. Code Civ. Proc. art. 531) is irrelevant for two reasons. First, the federal and state suits do not have the "same parties,"

Moreover, because the Fifth Circuit has decided the merits of the federal preemption claim, its judgment will, unless reversed, preclude NOPSI from litigating its facial preemption claim in the pending state appeals or any other forum. *See* Pet. 10-11 & n.8. Thus, the Fifth Circuit's judgment presents, if anything, a more compelling case for review than did the lower court's decision in *MP&L*. *See* Pet. 21-22.

Conclusion

Because this case is squarely controlled by this Court's decisions in *MP&L* and *Nantahala*, the Fifth Circuit's decision can be summarily reversed. Alternatively, the petition for a writ of certiorari should be granted and the case set for oral argument.

Respectfully submitted,

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which prevents any application of this statute. Second, this statute does not apply when parallel cases are pending in state and federal court, which is a subject addressed by a separate Louisiana *lis pendens* statute (*id.* art. 532). If this latter statute were otherwise applicable here (as it is *not* because the suits do not have the "same parties"), it would require a stay of the *state* suit and impose no limitation on the prosecution of federal court litigation.

(2)

No. 90-1156

Supreme Court, U.S.
FILED
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In the Supreme Court of the United States

OCTOBER TERM, 1990

NEW ORLEANS PUBLIC SERVICE, INC., PETITIONER

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE SUPPORTING PETITIONER

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QUESTION PRESENTED

Whether *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, 487 U.S. 354 (1988), and *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), require a state or local public utility commission to allow an electric utility to recover, in retail rates, its share, as determined by the Federal Energy Regulatory Commission, of the costs of an electric power generating facility that supplies power to the utility and sister utilities in three other States.

TABLE OF CONTENTS

	Page
Interest of the United States and the Federal Energy Regulatory Commission	1
Statement	2
Discussion	11
Conclusion	17

TABLE OF AUTHORITIES

Cases:

Burford v. *Sun Oil Co.*, 319 U.S. 315 (1943)	4
Colorado River Water Conservation Dist. v. *United States*, 424 U.S. 800 (1976)	8
FPC v. *Southern Cal. Edison Co.*, 376 U.S. 205 (1964)	14
Kentucky-West Virginia Gas Co. v. *Pennsylvania Pub. Utilities Comm'n*, 837 F.2d 600 (3d Cir. 1988)	10
Middle South Energy, Inc.:	
26 F.E.R.C. ¶ 63,044 (1984)	16
31 F.E.R.C. ¶ 61,305, on reh'g, 32 F.E.R.C. ¶ 61,425 (1985), aff'd *sub nom. Mississippi Indus.* v. *FERC*, 808 F.2d 1525, reh'g granted and vacated in part, 822 F.2d 1103 (D.C. Cir.), cert. denied, 484 U.S. 985 (1987), on remand *sub nom. System Energy Resources, Inc.*, 41 F.E.R.C. ¶ 61,238, aff'd, 42 F.E.R.C. ¶ 61,091 (1988), aff'd *sub nom. City of New Orleans* v. *FERC*, 875 F.2d 903 (D.C. Cir. 1989), cert. denied, 110 S. Ct. 1805 (1990)	3, 14
Mississippi Power & Light Co. v. *Mississippi ex rel. Moore*, 487 U.S. 354 (1988)	2, 6, 9, 10, 11, 12, 13, 14, 15, 16

Cases—Continued: Page

Moses H. Cone Memorial Hosp. v. *Mercury Constr. Corp.*, 460 U.S. 1 (1983) 8
Nantahala Power & Light Co. v. *Thornburg*, 476 U.S. 953 (1986) 2, 6, 10, 11, 13, 14, 16
New England Power Co., 31 F.E.R.C. ¶ 61,047 (1985), aff'd, 800 F.2d 280 (1st Cir. 1986) 12
New Orleans Public Service, Inc. v. *Council of New Orleans*, 109 S. Ct. 2506 (1989) 2, 3, 7, 9, 10, 15, 16
NOPSI v. *City of New Orleans*, 782 F.2d 1236, modified, 798 F.2d 858 (5th Cir. 1986), cert. denied, 481 U.S. 1023 (1987) 4
NOPSI v. *Council of New Orleans*, 833 F.2d 583 (5th Cir. 1987) 5
NOPSI v. *Council of New Orleans*, 850 F.2d 1069 (5th Cir. 1988) 6
NOPSI v. *Council of New Orleans*, No. 88-4511 (Civ. Dist. Ct., Parish of Orleans, La. Nov. 19, 1989) 7
Pike County Light & Power Co. v. *Pennsylvania Pub. Utility Comm'n*, 77 Pa. Commw. 268, 465 A.2d 735 (1983) 10
Younger v. *Harris*, 401 U.S. 37 (1971) 6

Statutes and regulations:

Federal Power Act, 16 U.S.C. 824 *et seq.* 1
16 U.S.C. 824(b) 3
16 U.S.C. 824d(a) 1
Johnson Act, 28 U.S.C. 1342 4
La. Rev. Stat. Ann. (West 1988):
§ 33:4405 3
§ 33:4495 3

Statutes and regulations—Continued: Page

Home Rule Charter of the City of New Orleans § 4-1604 (1986) 3
Ordinance No. 8264 M.C.S. Ordinance No. 10340 M.C.S. 3

In the Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-1156

NEW ORLEANS PUBLIC SERVICE, INC., PETITIONER

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI
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FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES AND
THE FEDERAL ENERGY REGULATORY COMMISSION
AS AMICI CURIAE SUPPORTING PETITIONER

INTEREST OF THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION

Part II of the Federal Power Act, 16 U.S.C. 824 *et seq.*, gives FERC exclusive regulatory authority over the wholesale sale and the transmission of electric energy in interstate commerce. FERC is responsible for ensuring that all rates or charges made, demanded, or received by a public utility for or in connection with the transmission or sale of electric energy in interstate commerce are "just and reasonable." 16 U.S.C. 824d(a). This case was preceded by FERC's decision, upon examination of the justness and reasonableness of two agreements filed with FERC by members of a four-state public utility holding company system, that the four operating companies of the system

shall purchase the capacity of a particular nuclear power plant owned by the system in proportions deemed just and reasonable by FERC. The court of appeals held in this case that the Council of the City of New Orleans may prohibit the system operating company serving customers in that city from recovering a substantial portion of the FERC-determined costs after finding that that portion was not prudently incurred by the operating company. If allowed to stand, the court of appeals' decision would effectively nullify FERC's allocation of costs among the four operating companies. FERC participated as amicus curiae in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), and in *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, 487 U.S. 354 (1988), because the decisions of the state supreme courts in those cases similarly threatened to nullify an exercise of FERC's exclusive statutory authority. [1]

STATEMENT

1. Petitioner, New Orleans Public Service, Inc. (NOPSI), is one of four operating electric utility companies that are wholly owned subsidiaries of Middle South Utilities, Inc. (MSU). See generally *Mississippi Power & Light Co.*, 487 U.S. at 357-360. The other subsidiaries, each of which sells electric power to its own local customers, are Louisiana Power & Light (LP&L), Mississippi Power & Light Company (MP&L), and Arkansas Power & Light Company (AP&L). A generating subsidiary, Middle South Energy (MSE), was formed to own and finance two nuclear power

[1] FERC also participated as amicus curiae when this case was previously before the Court on an abstention issue in *New Orleans Public Service, Inc.* v. *Council of New Orleans*, 109 S. Ct. 2506 (1989) (*NOPSI*).

plants, Grand Gulf 1 and 2, and to sell power from those plants to the operating companies. Pet. App. 3A-4A.

In June 1985, the Federal Energy Regulatory Commission approved wholesale rates for power from Grand Gulf 1 and allocated its capacity and energy among the four operating companies. See *Middle South Energy, Inc.*, 31 F.E.R.C. ¶ 61,305, on reh'g, 32 F.E.R.C. ¶ 61,425 (1985), aff'd *sub nom. Mississippi Indus.* v. *FERC*, 808 F.2d 1525, reh'g granted and vacated in part, 822 F.2d 1103 (D.C. Cir.), cert. denied, 484 U.S. 985 (1987), on remand *sub nom. System Energy Resources, Inc.*, 41 F.E.R.C. ¶ 61,238, aff'd, 42 F.E.R.C. ¶ 61,091 (1988), aff'd *sub nom. City of New Orleans* v. *FERC*, 875 F.2d 903 (D.C. Cir. 1989), cert. denied, 110 S. Ct. 1805 (1990). FERC rejected respondent New Orleans City Council's argument that NOPSI's share of Grand Gulf 1 costs should be 9 percent. FERC instead concluded that the operating companies should share in the system's total investment in nuclear capacity "roughly in proportion to each company's share of System demand." 31 F.E.R.C. at 61,655-61,656. FERC ordered the following allocation of Grand Gulf 1 costs: AP&L, 36 percent; LP&L, 14 percent; MP&L, 33 percent; and NOPSI, 17 percent. *Ibid.* MSE has accordingly billed NOPSI for 17 percent of the costs since Grand Gulf 1 went into service on July 1, 1985. Pet. App. 5A-6A.

Respondent, the City Council of New Orleans, regulates NOPSI's retail rates.[2] On May 17, 1985, NOPSI applied for a retail rate increase to reflect the Grand Gulf 1 costs that it would be required to pay under the FERC allocation. The Council, however, refused to allow NOPSI to

[2] See 16 U.S.C. 824(b); La. Rev. Stat. Ann. §§ 33:4405, 33:4495 (West 1988); Home Rule Charter of the City of New Orleans § 4-1604 (1986), as amended by Ordinance No. 8264 M.C.S., as amended by Ordinance No. 10340 M.C.S.; see also *NOPSI*, 109 S. Ct. at 2511.

recover its Grand Gulf 1 costs in retail rates. Pet. App. 3A, 6A-7A.

2. a. *NOPSI I*: In July 1985, the Council initiated a public hearing in order to determine "the legality and prudency [*sic*] of [NOPSI's contracts relating to Grand Gulf 1, and] the prudency and reasonableness of the said expenses." Council Res. R-85-423. NOPSI responded in August 1985 by filing a complaint in federal district court seeking declaratory and injunctive relief. NOPSI asked the court to issue preliminary and permanent injunctions enjoining the Council from denying NOPSI recovery, through its retail rates, of its FERC-allocated share of the expenses of Grand Gulf 1. Pet. App. 6A-7A.

In September 1985, the district court granted the Council's motion to dismiss, holding that dismissal was warranted under the Johnson Act, 28 U.S.C. 1342, and under *Burford* v. *Sun Oil Co.*, 319 U.S. 315 (1943).[3] On appeal, the court of appeals initially reversed both aspects of the district court's ruling, but on its own motion for reconsideration later reversed itself on the abstention issue. See *NOPSI* v. *City of New Orleans*, 782 F.2d 1236, modified, 798 F.2d 858 (5th Cir. 1986), cert. denied, 481 U.S. 1023 (1987).[4]

b. *NOPSI II*: While *NOPSI I* was pending before the court of appeals, the Council announced in October 1985 that it would conduct a prudence investigation into NOPSI

[3] In the meantime, the Council had denied NOPSI's request for interim rate relief. Council Res. R-85-5261.

[4] While the district court's ruling was pending on appeal, the Council and NOPSI entered into a settlement agreement concerning the treatment of Grand Gulf 1 costs. See Council Res. R-86-112. The agreement set out in detail the amounts by which NOPSI could increase its rate base annually until the costs of Grand Gulf 1 were fully recovered. Under the agreement, NOPSI also agreed permanently to absorb $51.2 million of the costs. Both sides purported to reserve their legal rights, including the Council's right to investigate the issue of prudence. See Council Res. R-86-112, at 4, 11-12.

expenditures on Grand Gulf 1. Council Res. R-85-636.[5] In November 1985, NOPSI filed a second lawsuit in federal district court in which it sought to enjoin the investigation. NOPSI later amended its complaint to seek an injunction or a declaratory judgment only to the extent that the Council proposed taking any action to require NOPSI or its shareholders to absorb all or a portion of the cost of Grand Gulf 1 allocated to NOPSI by FERC. Pet. App. 7A.

In December 1986, the district court dismissed NOPSI's complaint on ripeness grounds, and in the alternative abstained. Pet. App. 7A. On appeal, the court of appeals affirmed the judgment on the ripeness issue. *NOPSI* v. *Council of New Orleans*, 833 F.2d 583 (5th Cir. 1987).

3. a. *NOPSI III*: In February 1988, the Council issued a rate order based on its completed prudence inquiry. The Council found: (1) NOPSI's "oversight and review of its Grand Gulf obligation as the project went forward was uncritical and severely deficient," R.E. 32;[6] (2) NOPSI "made no effort to reduce its risk exposure" in the wake of the Three Mile Island Nuclear incident in 1979-80, R.E. 33; and (3) NOPSI imprudently failed to reduce the risk of its Grand Gulf commitment by "selling all or part of its share off-system," R.E. 33. Based on these findings, the Council disallowed $135 million of NOPSI's deferred Grand Gulf

[5] As the court below noted:

> The resolution specifically provided that, in determining the appropriate retail rate increase, the Council would not seek to invalidate any of the agreements surrounding Grand Gulf 1 or to order NOPSI to pay MSE a wholesale rate other than that approved by FERC.

Pet. App. 7A.

[6] "R.E." refers to the Record Excerpts filed with NOPSI's brief in the court of appeals.

costs and required NOPSI to deduct that amount from its rate base. R.E. 34-35.[7]

NOPSI then filed the instant action in federal district court, seeking a declaratory judgment and both preliminary and permanent injunctive relief from the Council's order. NOPSI contended that federal law preempted that order. See *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986). In March 1988, the district court dismissed NOPSI's complaint, holding that abstention under both *Burford* and *Younger* v. *Harris*, 401 U.S. 37 (1971), was appropriate.[8] In July 1988, the court of appeals affirmed. *NOPSI* v. *Council of New Orleans*, 850 F.2d 1069 (5th Cir. 1988).[9]

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[7] In order to reflect the disallowance, the Council also reduced rate increases then planned for NOPSI. The Council explained, however, that the amount disallowed did not reflect the full extent of NOPSI's imprudence, because that amount would have caused NOPSI to become insolvent. The Council had instead disallowed only that amount – minus an additional ten percent "buffer" – that it concluded NOPSI could absorb without becoming insolvent. R.E. 34-35.

[8] In June 1988, this Court issued its decision in *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, 487 U.S. 354 (1988). There, the Court held that the underlying FERC allocation proceedings at issue here preempted a prudence inquiry by the Mississippi Public Service Commission regarding MP&L's payments for Grand Gulf costs. *Id.* at 369-377.

[9] NOPSI had also filed a complaint (petition of appeal) in state court, seeking relief against the Council's order based on several state and federal grounds (later amended to include the federal preemption contention). *NOPSI* v. *Council of New Orleans*, No. 88-4511 (Civ. Dist. Ct., Parish of Orleans, La. filed Mar. 7, 1988). NOPSI's state action was later consolidated with a declaratory judgment action filed earlier by the Council, seeking a declaration that the Council's rate order represented a just and reasonable exercise of the Council's power and that NOPSI's failure to comply with the order would be unlawful, *Boissiere* v. *Cain*, No. 88-2503 (Civ. Dist. Ct., Parish of Orleans, La. filed Feb. 4, 1988), and with a suit filed by a local consumers' rights organization, seeking to force the Council to disallow more of the Grand Gulf costs, *Alliance for Affordable Energy, Inc.* v. *Council of New Orleans*, No. 88-2502 (Civ. Dist. Ct., Parish of Orleans, La. filed Feb. 4, 1988).

In November 1989, the state trial court rejected the challenges raised by NOPSI and others and therefore sustained the Council's order in its entirety. *NOPSI* v. *Council of New Orleans*, No. 88-4511 (Civ. Dist. Ct., Parish of Orleans, La., Nov. 19, 1989). NOPSI's appeal of the trial court's judgment is pending before a state appellate tribunal. See *NOPSI* v. *Council of New Orleans*, No. 90-CA-0420 (4th Cir. La. Ct. App.) (argued Nov. 7, 1990).

b. In June 1989, this Court reversed and remanded for further proceedings, holding abstention improper under either *Burford* or *Younger*. *New Orleans Public Service, Inc.* v. *Council of New Orleans*, 109 S. Ct. 2506 (1989) (*NOPSI*). In particular, the Court concluded that abstention under *Burford* was not warranted where, as here, "no inquiry beyond the four corners of the Council's retail rate order is needed to determine whether it is facially pre-empted by FERC's allocative decree and relevant provisions of the Federal Power Act." *NOPSI*, 109 S. Ct. at 2515. Similarly, the Court concluded that abstention was inappropriate with respect to NOPSI's alternative claim, namely, "that the rate order's nominal emphasis on NOPSI's failure in 1979-1980 to diversify its power supply by selling off a portion of its Grand Gulf allocation was merely a cover for the determination that the original Grand Gulf investment was itself unwise." *Ibid.*[10]

c. On remand before the district court, NOPSI renewed its claims that federal law preempted the Council's order.

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[10] With respect to abstention under *Younger*, the Court concluded:

> Viewed, as it should be, as no more than a state-court challenge to completed legislative action, [NOPSI's] Louisiana suit comes within none of the exceptions that *Younger* and the later cases have established.

109 S. Ct. at 2520.

NOPSI first contended that the order "on its face * * * impermissibly contradicted the FERC order," and in the alternative, "that the Council's reasons for denying a pass-through were a pretext to attack the FERC allocation." Pet. App. 8A.

In January 1990, the district court rejected NOPSI's claims and therefore stayed further proceedings pending completion of parallel state court litigation. Pet. App. 26a-32A; see note 9, *supra*. The court held that "[f]acially, the Council's Order is not preempted by federal law." Pet. App. 26A. As the court explained:

> An examination into the "four corners" of the Council's Order reveals that it is not facially preempted. The Council's decision did not question the validity of FERC's allocative decree, and the Council did not attempt to regulate interstate utility rates. Instead, the Council's inquiry focused solely upon whether NOPSI prudently managed its participation in Grand Gulf.

Id. at 27A. With respect to the remainder of the case, which the court described as "NOPSI's claim that the Council's Order is unsupported by the evidence," *ibid.*, the court stayed further proceedings under the principles set forth in *Moses H. Cone Memorial Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1 (1983), and *Colorado River Water Conservation Dist.* v. *United States*, 424 U.S. 800 (1976). Pet. App. 27A-32A.

4. In August 1990, the court of appeals affirmed. Pet. App. 2A-24A. As a threshold matter, the court recognized that "*Nantahala* and *Mississippi Power and Light* reaffirmed the well-established principle that if FERC has jurisdiction over a subject, states cannot have jurisdiction over it." *Id.* at 15A-16A. The court further noted that the latter decision

> established that FERC had jurisdiction to determine whether the various utilities acted prudently in deciding

> to participate in the Grand Gulf venture, and that the states were therefore precluded from conducting prudence inquiries on that subject.

Id. at 16A. This case, the court determined, "presents a variation of that question," *i.e.*, "whether FERC has jurisdiction to determine whether NOPSI acted prudently once the Grand Gulf project was underway." *Ibid.*[11]

Turning to that question, the court first concluded that "it is plain that FERC did not assert jurisdiction to determine NOPSI's prudence in not acting to minimize its losses." Pet. App. 16A. The court next determined that "this is [not] a matter that Congress has nevertheless committed to FERC's exclusive jurisdiction." *Id.* at 17A. As the court pointed out,

> finding such jurisdiction would work the result Justice Brennan feared in *Mississippi Power and Light*, that is, to "divest states of authority to determine the prudence of costs incurred by retail utilities whenever those utilities belong to an interstate pool."

Ibid. (quoting *Mississippi Power & Light Co.*, 487 U.S. at 391 (Brennan, J., dissenting)). Finally, the court explained that "[i]f states may deny pass throughs because costs have gone down in other areas, it seems logical that they should be able to deny them because costs would have gone down if the utility had not been imprudent." Pet. App. 18A (citing

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[11] The court of appeals pointed out that in *NOPSI*, 109 S. Ct. at 2517, this Court had characterized the Council's order as follows:

> [T]he Council maintains that it has examined the prudence of NOPSI's failure, after the risk of nuclear power became apparent, to diversify its supply portfolio, and that finding that failure negligent, it has taken the normal ratemaking step of making NOPSI's shareholders rather than the ratepayers bear the consequences.

Pet. App. 15A.

Nantahala, 476 U.S. at 968). Accordingly, the court held that the Council's order "is not facially preempted." Pet. App. 18A.[12]

With respect to NOPSI's pretext claim, the court of appeals concluded that, in light of the Court's observations in *NOPSI*, 109 S. Ct. at 2512 n.2, "the pretext claim is inevitably a review of the sufficiency of the evidence to support the Council's stated reasons for denying the pass through." Pet. App. 21A. The court therefore stated that, "[i]f there is an adequate basis in the record to support the Council's action, federal courts may not invalidate it on a suspicion that the Council members' motives were improper." *Ibid*. The court rejected NOPSI's contention that a further inquiry was required, holding that the "pretext claim has little functional difference from the state court's sufficiency of the evidence review, and motivation is not relevant." *Id*. at 22A. In these circumstances, the court of appeals concluded, the district court had not abused its discretion in staying further proceedings on NOPSI's pretext challenge pending completion of the parallel state court litigation, since there were "no substantial federal questions remaining in the case." *Id*. at 24A.

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[12] The court correctly acknowledged, however, that the so-called "*Pike Co.*" exception to FERC's exclusive wholesale jurisdiction – when a utility imprudently purchases unnecessary quantities of high-cost power at FERC-approved rates – was inapplicable. Pet. App. 15A; see, *e.g.*, *Kentucky-West Virginia Gas Co. v. Pennsylvania Pub. Utilities Comm'n*, 837 F.2d 600 (3d Cir. 1988); *Pike County Light & Power Co. v. Pennsylvania Pub. Utility Comm'n*, 77 Pa. Commw. 268, 465 A.2d 735 (1983). That exception does not apply where, as here, FERC has determined the amount of power that each operating utility in the interstate pool was obligated to purchase. See *Mississippi Power & Light Co.*, 487 U.S. at 373-374.

DISCUSSION

The decision of the court of appeals is inconsistent with the Court's decisions in *Mississippi Power & Light Co.* and *Nantahala*. As the Court expressly reaffirmed in *Mississippi Power & Light Co.*,

> "a state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price. . . . Once FERC sets such a rate, a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable."

487 U.S. at 373 (quoting *Nantahala*, 476 U.S. at 965, 966). In the FERC proceedings here, in which the Council participated, FERC determined the wholesale price to be paid by NOPSI for power it acquires: FERC ruled that NOPSI, which draws all of its power from a variety of sources within the MSU system, should purchase 17 percent of the power of Grand Gulf 1. FERC's authority to impose this obligation and associated costs on NOPSI was affirmed by the D.C. Circuit and reduced to final judgment. See p. 3, *supra*. The decision below, barring NOPSI from passing a substantial portion of the costs of purchasing its share of Grand Gulf 1 power on to its customers and therefore forcing those costs to be paid instead by its parent or shareholders, would, if allowed to stand, effectively nullify a FERC decision in which the Council fully participated.

The court of appeals justified its conclusion on the ground that FERC does not have – and did not purport to exercise – exclusive "jurisdiction to determine whether NOPSI acted prudently once the Grand Gulf project was underway." Pet. App. 16A. The court therefore determined that the Council may, consistent with federal law, "conduct[] prudence inquiries on that subject." *Ibid*. The Court's decisions in *Mississippi Power & Light Co.* and *Nantahala*

foreclose that argument. First, the so-called "prudency" review traverses matters squarely within the exclusive jurisdiction of FERC. Second, this is a case like *Mississippi Power & Light Co.* and *Nantahala*, where all the relevant sources of electric power are within the utility system and the sole question—one that only FERC can properly and fairly resolve—is how the benefits and burdens of those sources should be shared between affiliated companies doing business in different States.

1. First, contrary to the court of appeals' assumption, the Council has no jurisdiction to decide that NOPSI imprudently participated in the Grand Gulf 1 project and that NOPSI (and MSU) and their shareholders must therefore bear some of the project's costs. The question whether MSU and its subsidiary MSE, which owns Grand Gulf 1, may charge the operating companies the full costs of Grand Gulf 1 as part of the price of the power that facility supplies to them is a question of the justness and reasonableness of the terms of interstate wholesale transactions in electric power, and it is within the exclusive jurisdiction of FERC. FERC had jurisdiction to consider the argument that Grand Gulf 1 costs were imprudently incurred and should not be passed through to operating utilities that are, for this purpose, wholesale customers. As this Court recognized, however, "[t]he question of prudence was not discussed * * * because no party raised the issue, not because it was a matter beyond the scope of FERC's jurisdiction." *Mississippi Power & Light Co.*, 487 U.S. at 375.[13]

[13] If FERC had found that decisions relating to the Grand Gulf 1 project were imprudent, FERC could have determined that it was not just and reasonable for MSU and MSE to charge the four operating utilities, including NOPSI, the full cost of Grand Gulf 1 power. In that circumstance, MSU's shareholders would have had to absorb those costs. See *New England Power Co.*, 31 F.E.R.C. ¶ 61,047, at 61,084 (1985), aff'd, 800 F.2d 280 (1st Cir. 1986). Indeed, the Court expressly recognized this point in *Mississippi Power & Light Co.* See 487 U.S. at 375.

FERC determined that the full costs should be borne by the operating companies such as NOPSI in specified proportions. This Court's pronouncement in *Mississippi Power & Light Co.* squarely applies to the Council's efforts at issue here:

> [The Council] may not enter an order "trapping" the costs [NOPSI] is mandated to pay under the FERC order allocating Grand Gulf power or undertake a "prudence" review for the purpose of deciding whether to enter such an order.

487 U.S. at 372.[14] As this Court has made plain,

> a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable. A State must rather give effect to Congress' desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the States do not interfere with this authority.

Id. at 373 (quoting *Nantahala*, 476 U.S. at 966).

At bottom, as this Court has recognized, "[t]he reasonableness of rates and agreements regulated by FERC may not be collaterally attacked in state or federal courts. The only appropriate forum for such a challenge is before the Commission or a court reviewing the Commission's order." *Mississippi Power & Light Co.*, 487 U.S. at 375. Here, the Council's "prudency" review and resulting order

[14] As in *Mississippi Power & Light Co.*, "[i]t is clear that the only purpose of the prudence review ordered by the [Council] was to determined whether the costs FERC had directed [NOPSI] to pay for its allocation of Grand Gulf power should be 'trapped' or passed on to [NOPSI's] retail customers." 487 U.S. at 372 n.12.

amount to precisely that sort of impermissible collateral attack on FERC's allocation of Grand Gulf costs.[15]

Second, the court of appeals erred in attaching any significance to its view that "FERC did not assert jurisdiction to determine NOPSI's prudence in not acting to minimize its losses." Pet. App. 16A. As an initial matter, the court's view is factually inaccurate. Indeed, this Court recognized as much in *Mississippi Power & Light Co.*, 487 U.S. at 376.[16] In any event, this Court has "long rejected this sort of 'case-by-case analysis of the impact of state regulation upon the national interest' in power regulation cases." *Id.* at 374 (quoting *Nantahala*, 476 U.S. at 966, and *FPC* v. *Southern Cal. Edison Co.*, 376 U.S. 205, 215-216 (1964)). As the Court further emphasized just three Terms

[15] For these reasons, the court of appeals erred (Pet. App. 17A) in relying on the concern cited by Justice Brennan in *Mississippi Power & Light Co.*, 487 U.S. at 391 (Brennan, J., dissenting), namely, that the States' authority to determine the prudence of retail utility members of interstate pools would be divested if FERC undertakes that sort of inquiry. Justice Brennan based such a concern on his conclusion that FERC does not have jurisdiction over the prudence of a pool member's purchase decision. See *id.* at 384-390. This Court, however, held to the contrary. See *id.* at 374-376 (opinion of the Court); *id.* at 377-383 (Scalia, J., concurring in the judgment).

[16] FERC did consider the prudence issue in determining the appropriate allocation of the capacity and costs of Grand Gulf 1 among the four operating companies. FERC found that Grand Gulf 1 was part of a reasonable system plan to diversify the fuel base by developing nuclear power to meet anticipated growth in demand, but that the system experienced "unexpectedly dramatic" increases in the costs of the facility. 31 F.E.R.C. at 61,654-61,655. FERC also explicitly affirmed and adopted the findings and conclusions of its administrative law judge who determined that MSU's decisions both to begin and to complete construction of Grand Gulf 1 were prudent. See 26 F.E.R.C. at 65,112-65,113; 31 F.E.R.C. at 61,655, 61,666.

ago in *Mississippi Power & Light Co.*, where it reviewed the same FERC allocation decision underlying this case:

> States may not regulate in areas where FERC has properly exercised its jurisdiction to determine just and reasonable wholesale rates or to insure that agreements affecting wholesale rates are reasonable. FERC's jurisdiction to adjust the allocation of Grand Gulf power [among the operating utilities] has been established. Mississippi, therefore, may not consistent with the Supremacy Clause conduct any proceedings that challenge the reasonableness of FERC's allocation.

487 U.S. at 374. For those reasons, as in *Mississippi Power & Light Co.*, the Council here "cannot evaluate * * * the prudence of [NOPSI's] decision to be a party to agreements to construct and operate Grand Gulf without traversing matters squarely within FERC's jurisdiction." *Id.* at 376. In sum, contrary to the court of appeals' view, there are not two separate and distinct prudence inquiries in this case—one for FERC and the other for state regulatory bodies such as the Council. Rather, as this Court recognized in *Mississippi Power & Light Co.*, there is only one broad inquiry and FERC alone is empowered to make it.

2. The court of appeals avoided an otherwise straightforward application of the preemption holdings in *Mississippi Power & Light Co.* and *Nantahala* by mistakenly relying on statements in the Court's recent abstention decision in *NOPSI*. The court of appeals stated:

> [W]e are convinced that the Court in *NOPSI* * * * did not believe the Council could not regulate NOPSI's activities in this regard. It said that nothing in the Council's order was directly or even indirectly foreclosed by prior preemption decisions.

Pet. App. 17A (citing *NOPSI*, 109 S. Ct. at 2517).

First, as even the court of appeals correctly recognized, in *NOPSI*, "the Court held only that the [Council's] order was not 'flagrantly' unlawful for *Younger* abstention purposes; it did not hold the facial preemption claim was foreclosed." Pet. App. 10A (citing *NOPSI*, 109 S. Ct. at 2517). For that reason alone, the Court's statements in *NOPSI* cannot bear the weight the court of appeals would have them carry. Second, the Court's crafting of a "facial preemption" inquiry in *NOPSI* for purposes of *Burford* abstention cannot fairly be construed to overturn—without any discussion—well-settled federal preemption doctrine. Such a construction may not stand particularly where, as here, the Court has recently reaffirmed that doctrine in a case involving the same FERC allocation order. See *Mississippi Power & Light Co.*, 487 U.S. at 369-377.

Finally, the "perfectly sensible" exception to FERC preemption the Court noted in *Nantahala*, 476 U.S. at 967-968, does not call for the court of appeals' construction of the Court's statements in *NOPSI*. See Pet. App. 17A-18A. In *Nantahala*, the Court observed that "an increase in FERC-approved wholesale rates need not lead to an increase in retail rates." 476 U.S. at 967. But as petitioner correctly explains, "[t]he reason for this rule is that a utility can experience offsetting 'cost savings in other areas' that FERC does not regulate." Pet. 16 n.14 (citing *Nantahala*, 476 U.S. at 968). In this case, the *Nantahala* exception is inapplicable, since the Council has acted in an area of exclusive federal concern—it barred NOPSI's recovery of costs that FERC regulated (and in fact found to be just and reasonable). Hence, the holding and rationale of this Court's decision in *Mississippi Power & Light Co.* are directly controlling here, and nothing in the Court's opinion in *NOPSI* suggests the contrary.

CONCLUSION

The petition for a writ of certiorari should be granted, and the judgment of the court of appeals should be reversed.

Respectfully submitted.

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No. 90-1156

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

NEW ORLEANS PUBLIC SERVICE INC.,

Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, JOSEPH I. GIARRUSSO, LAMBERT C. BOISSIERE, JR., MICHAEL EARLY, JAMES SINGLETON, DOROTHY MAE TAYLOR, JOHNNY JACKSON and PEGGY WILSON,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

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BRIEF OF EDISON ELECTRIC INSTITUTE AS AMICUS CURIAE IN SUPPORT OF THE PETITION OF NEW ORLEANS PUBLIC SERVICE INC. FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether a retail ratemaking authority has the jurisdiction to nullify the Federal Energy Regulatory Commission's wholesale rate allocation order by deciding it was "imprudent" for a utility to fail to "minimize its losses" during construction of a wholesale generating facility and by barring recovery by the utility of, and thereby "trapping," wholesale costs that FERC found to be "just and reasonable" and ordered the utility to incur?

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
TABLE OF AUTHORITIES	iii
OPINION BELOW	1
INTEREST OF EDISON ELECTRIC INSTITUTE	2
STATEMENT OF THE CASE	5
SUMMARY OF ARGUMENT	7
ARGUMENT: THE OPINION BELOW IS OF GREAT NATIONAL IMPORTANCE SINCE, IN VIOLATING THE PREEMPTION DOCTRINE OF *NANTAHALA* AND *MP&L*, IT THREATENS THE PROPER RELATIONSHIP BETWEEN FEDERAL AND STATE REGULATION OF THE ELECTRIC UTILITY INDUSTRY	8
CONCLUSION	17

TABLE OF AUTHORITIES

Cases:	Page
City of New Orleans v. Federal Energy Regulatory Commission, 875 F.2d 903 (D.C. Cir. 1989), *cert. denied sub nom. State of Mississippi v. Federal Energy Regulatory Commission*, ___ U.S. ___, 110 S. Ct. 1805 (1990)	5
Eastern Edison Company v. Department of Public Utilities, 446 N.E.2d 684 (Mass. 1983)	16-17
Mississippi Industries v. Federal Energy Regulatory Commission, 808 F.2d 1525 (D.C. Cir.), *vacated in part*, 822 F.2d 1104, *cert. denied sub nom. Arkansas Public Service Commission v. FERC*, 484 U.S. 985, 108 S. Ct. 500 (1987)	5
Mississippi Power & Light Company v. Mississippi ex rel. Moore, 487 U.S. 354, 108 S. Ct. 2428 (1988)	*passim*
Nantahala Power and Light Company v. Thornburg, 476 U.S. 953, 106 S. Ct. 2349 (1986)	*passim*
Narragansett Electric Company v. Burke, 381 A.2d 1358 (R.I. 1977) *cert. denied*, 435 U.S. 972, 98 S. Ct. 1614 (1978)	15
New Orleans Public Service Inc. v. Council of New Orleans, 491 U.S. 350, 109 S. Ct. 2506 (1989)	14-15
New Orleans Public Service Inc. v. Council of New Orleans, 911 F.2d 993 (5th Cir. 1990)	*passim*
Northern States Power Company v. Hagen, 314 N.W.2d 32 (N.D. 1981)	16
Northern States Power Company v. Minnesota Public Utilities Commission, 344 N.W.2d 374 (Minn.), *cert. denied sub nom. Humphrey v. Northern States Power Co.*, 467 U.S. 1256, 104 S. Ct. 3546 (1984)	17

Table of Authorities Continued

	Page
Pike County Light and Power Company v. Pennsylvania Public Utility Commission, 465 A.2d 735 (Pa. Commw. Ct. 1983)	16
State ex rel. Utilities Commission v. Nantahala Power and Light Company, 332 S.E.2d 397 (N.C. 1985), *rev'd sub nom. Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953, 106 S. Ct. 2349 (1986)	9
Administrative Decisions:	
Middle South Energy, Inc., Opinion No. 234, 31 FERC ¶ 61,305 (1985)	*passim*
Middle South Energy, Inc., Opinion No. 234-A, 32 FERC ¶ 61,425 (1985)	*passim*
System Energy Resources, Inc., Opinion No. 292, 41 FERC ¶ 61,238 (1987)	*passim*
System Energy Resources, Inc., Opinion No. 292-A, 42 FERC ¶ 61,091 (1988)	*passim*

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On Petition For A Writ of Certiorari To The United States Court of Appeals For The Fifth Circuit

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BRIEF OF EDISON ELECTRIC INSTITUTE AS AMICUS CURIAE IN SUPPORT OF THE PETITION OF NEW ORLEANS PUBLIC SERVICE INC. FOR A WRIT OF CERTIORARI

OPINION BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is reproduced in the Appendix ("App.") to the Petition (App. 2A-24A) and is reported at 911 F.2d 993.

INTEREST OF EDISON ELECTRIC INSTITUTE

Edison Electric Institute ("EEI") is the nation's association of investor-owned electric utilities.[1] Its members generate approximately 78 percent of all electricity in the nation and serve 74 percent of the nation's electricity users. The ability of many EEI members to provide reliable electric service under rates that are just and reasonable to their customers and to their shareholders depends heavily on a regulatory structure in which the Federal Energy Regulatory Commission ("FERC") and state or local regulatory bodies operate compatibly. Within this structure, only the FERC can serve the vital function of offering a central, neutral forum for resolution of many interstate regulatory disputes by virtue of its authority to issue a decision with respect to wholesale cost allocation and rate issues that is binding on each affected state.

The federal preemption doctrine as applied to this nation's electric utility industry forms a fundamental and essential part of the regulatory structure in which the FERC performs this vital function. The doctrine is set forth in this Court's recent decisions in *Nantahala Power and Light Company v. Thornburg*, 476 U.S. 953, 106 S. Ct. 2349 (1986) ("*Nantahala*"), and *Mississippi Power & Light Company v. Mississippi ex rel. Moore* ("*MP&L*"), 487 U.S. 354, 108 S. Ct. 2428 (1988). The opinion of the court below is completely opposed to the sound preemption principle of

[1] EEI has obtained consent to file this brief from petitioner and respondents. Consents have been filed with the Clerk of the Court, concurrently with the filing of this brief.

Nantahala and *MP&L*[2] and therefore represents a major threat to a compatible federal-state regulatory structure.

Petitioner, New Orleans Public Service Inc. ("NOPSI"), its operating company affiliates, Mississippi Power & Light Company ("MP&L"), Arkansas Power & Light Company ("AP&L"), and Louisiana Power & Light Company ("LP&L") (collectively referred to hereafter as the "MSU System operating companies"), System Energy Resources, Inc., formerly known as Middle South Energy, Inc. ("MSE" or "SERI"), the owner of a 90 percent interest in Grand Gulf Station Unit No. 1 ("Grand Gulf 1"), and their common parent, Entergy Corporation, formerly known as Middle South Utilities, Inc. ("MSU"), constitute a highly integrated and coordinated electric utility system. All are members of EEI. The MSU System is subject to retail rate regulation in the states of Louisiana, Mississippi, Arkansas, Missouri and the City of New Orleans.

In addition to the MSU System operating companies, most other EEI members throughout the country obtain a portion of their total supply of electrical capacity and energy available to sell to their retail customers through interstate, wholesale purchases from other utilities or from generating companies at rates regulated exclusively by the FERC. Many EEI members, including NOPSI and its sister companies within the MSU System, also participate in interstate, multiparty power pools that include provisions for reciprocal wholesale sales and exchanges of electrical capacity and energy; others have invested in electrical generation projects that are jointly owned by utilities

[2] EEI submitted briefs as *amicus curiae* in both of those cases.

with separate retail service areas. These baseload, generating projects also typically involve large, wholesale sales of power.

Many EEI member companies thus are exposed to a blend of regulation that includes the FERC and at least one state or municipal authority but, quite possibly, may include two or more state or local authorities. This blend of regulation can lead to serious, if not debilitating, ratemaking conflicts absent the enforcement of a properly framed rule of federal preemption. As this Court noted in *Nantahala*, an improper refusal on the part of a state to permit an electric company to pass through wholesale costs that have been approved by the FERC causes a "trapping" of costs.

Trapped costs could threaten the ability of an individual utility to provide adequate and reliable electric service within its defined service area by sapping the financial strength of the victimized utility. In the long run, a utility's customers suffer from any loss of reliability due to financial erosion. Despite this Court's decisions in *Nantahala* and *MP&L*, these conflicts still persist, at least within the Fifth Circuit. NOPSI is suffering from a *Nantahala* trapping of costs that has lasted for virtually six years. Utility managers and federal and state regulators across the nation are watching to see how NOPSI's efforts to overturn this trapping are resolved; and the lower court's decision has profound adverse implications for the nation's electric utility industry if it is sustained.

Therefore, EEI's members have a vital interest in the outcome of this case. EEI urges this Court to grant the Petition and summarily reverse the lower court's decision.

STATEMENT OF THE CASE

From 1974 to 1985 as part of a major supply diversification program on behalf of the MSU System, MSE (now SERI) constructed Grand Gulf 1 for the mutual benefit of NOPSI and the other MSU System operating companies. Since MSE would sell the entire output of its interest in Grand Gulf 1 at wholesale to the MSU System operating companies (for resale by them as part of their general system power supplies), FERC had exclusive and total rate jurisdiction with respect to MSE. In anticipation of commercial operation of Grand Gulf 1, the FERC held lengthy, exhaustive and highly contentious evidentiary hearings during 1983 and 1984. In these hearings, the Council of the City of New Orleans ("Council") and the affected states were given an unfettered opportunity to challenge the allocation of Grand Gulf 1 on all conceivable fronts including prudence. The Council and the states of Louisiana, Arkansas and Mississippi each sought to obtain an allocation of Grand Gulf 1 costs that would have imposed more costs on the other jurisdictions.

In Opinion No. 234, issued in 1985, and subsequent affirming orders ("Opinion No. 234, *et seq.*"),[3] the

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[3] *Middle South Energy, Inc.*, Opinion No. 234, 31 FERC ¶ 61,305 (1985); Opinion No. 234-A, 32 FERC ¶ 61,425 (1985); *System Energy Resources, Inc.*, Opinion No. 292, 41 FERC ¶ 61,238 (1987); Opinion No. 292-A, 42 FERC ¶ 61,091 (1988). *See also Mississippi Industries v. FERC*, 808 F.2d 1525 (D.C. Cir.), *vacated in part*, 822 F.2d 1104, *cert. denied sub nom. Arkansas Public Service Commission v. FERC*, 484 U.S. 985, 108 S. Ct. 500 (1987); *City of New Orleans v. FERC*, 875 F.2d 903 (D.C. Cir. 1989), *cert. denied sub nom. State of Mississippi v. FERC*, ___ U.S. ___, 110 S. Ct. 1805 (1990).

FERC ultimately determined a just and reasonable allocation of Grand Gulf 1 investment costs among NOPSI and the other MSU System operating companies. It allocated 36 percent of the large and expensive nuclear unit to AP&L, 33 percent to MP&L, 17 percent to NOPSI and 14 percent to LP&L in order to achieve an approximate equalization of wholesale cost responsibility among the MSU System operating companies. This was in keeping with the highly integrated and closely coordinated nature of the MSU System.

Subsequently, each MSU System operating company sought authorization from its respective retail rate commission to pass through the costs of its FERC-approved portion of Grand Gulf 1 in retail rates. Retail rate settlements consistent with the FERC-approved allocation of Grand Gulf 1 were obtained by AP&L and LP&L and their respective state regulators. MP&L's effort to pass through its share of the FERC-approved costs culminated in this Court's 1988 opinion in *MP&L*. This case arises from NOPSI's effort, commencing almost six years ago, to obtain authorization from the Council to pass through all costs associated with NOPSI's FERC-approved allocation of Grand Gulf 1.

Underneath the layers of federal and state court decisions produced in NOPSI's effort is the Council's February 4, 1988 order[4] refusing to permit NOPSI to recover $135 million of its Grand Gulf 1 costs. The Council's order rests on the misguided grounds that NOPSI was imprudent for failing to "minimize its

[4] See Petition at 7 for a description of this order.

losses" with respect to Grand Gulf 1 during that unit's construction period although the unit itself had been constructed prudently as the FERC found. *MP&L*, 487 U.S. at 375. This disallowance had the effect of reducing NOPSI's Grand Gulf 1 cost responsibility from the 17 percent found reasonable by FERC to 9 percent — the allocation the Council unsuccessfully urged before FERC on non-prudence grounds, since no party including the Council had chosen to raise any serious prudence issue at the FERC. *Id.* at 375.

On appeal, the U.S. Court of Appeals for the Fifth Circuit held that the Council's February 4, 1988 order is not "facially preempted" by FERC's Opinion No. 234, *et seq.* The court held that this Court's prior preemption decisions established only that "FERC had jurisdiction to determine whether [NOPSI and the other MSU utilities] acted prudently in deciding to participate in the Grand Gulf venture" initially and that *MP&L*, *Nantahala*, and other preemption cases had not addressed FERC's jurisdiction to determine prudence "once the Grand Gulf project was underway." 911 F.2d at 1001, App. 16A.

SUMMARY OF ARGUMENT

The Council's order is based on the theory that NOPSI was imprudent in allegedly failing to minimize its losses during the construction of Grand Gulf 1. This theory is a sham designed to evade the clear preemptive effect of Opinion No. 234, *et seq.*, in which the FERC, after giving the Council an unrestricted opportunity to challenge the prudence of Grand Gulf 1 on any conceivable basis, properly allocated a portion of the nuclear unit to NOPSI. In accepting the Council's minimization-of-losses-during-construction-of-

Grand Gulf 1 theory, the lower court's opinion patently violates *Nantahala* and *MP&L* and merits summary reversal.

ARGUMENT

The Opinion Below Is Of Great National Importance Since, In Violating The Preemption Doctrine Of *Nantahala* and *MP&L*, It Threatens The Proper Relationship Between Federal and State Regulation Of The Electric Utility Industry.

Contrary to the erroneous opinion of the court below, there can be no doubt that, in accordance with this Court's recent decisions in *Nantahala* and *MP&L*, the Council's action is preempted by the FERC-approved allocation of Grand Gulf 1 costs. Indeed, the lower court's decision, like the Council's action itself, flouts this Court's application of the preemption doctrine in this very context.

In *Nantahala*, this Court considered the preemptive effect of a FERC rate order that allocated to two affiliated electric companies with a common parent their respective entitlements to a particular power resource (low cost power produced by the Tennessee Valley Authority ("TVA") from hydroelectric facilities) that was available to them pursuant to a joint power supply arrangement. One of the affiliated utilities operated in the state of North Carolina and the other in Tennessee. The two utilities and their parent formed a small interstate electric system similar in nature in many respects to the MSU System.

The North Carolina Utilities Commission ("NCUC") had found that a portion of the North Carolina utility's power purchase costs, in light of the presumed availability of additional lower-cost power from TVA, had been incurred for the benefit of the utility's

shareholders and not for its customers. Therefore, the NCUC assumed that for retail ratemaking purposes it could allocate more lower cost TVA power to the utility than was available to the utility under the FERC's allocation. *State ex rel. Utilities Commission v. Nantahala Power & Light Co.*, 332 S.E.2d 397 (N.C. 1985) *rev'd sub nom. Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953, 106 S. Ct. 2349 (1986). Thus, the effect was to deny that utility the right to recover a portion of the costs it had incurred in paying wholesale rates that FERC had determined to be just and reasonable.

The North Carolina Supreme Court held that the state's reallocation was well within North Carolina's traditional range of authority (the "historic police powers" rationale of the opinion below, 911 F.2d at 1002, App. 17A) and emphasized that the state had not required the utility to violate FERC's rate order, nor had the FERC's allocation been contradicted directly or indirectly. *See Nantahala*, 476 U.S. at 961-62. This Court rejected those arguments, stating with complete clarity:

> When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate. . . . Such a "trapping" of costs is prohibited. Here, Nantahala cannot fully recover its costs of purchasing at the FERC-approved rate if NCUC's order is allowed to stand.

Id. at 970 (citation omitted).

In *MP&L*, this Court again considered the preemptive effect of a FERC ratemaking order that allocated the costs and electrical output of a jointly available generating resource among affiliated electric utilities. The FERC decision involved in *MP&L* is the same one involved in this case — Opinion No. 234, *et seq.*, which allocated Grand Gulf 1 among NOPSI and the other MSU System operating companies. In *MP&L*, the Mississippi Supreme Court ruled that the state of Mississippi could not permit the pass-through of MP&L's allocated portion of Grand Gulf 1 costs without first reviewing the prudence of management decisions concerning Grand Gulf 1. The Mississippi Supreme Court rejected MP&L's argument that *Nantahala* foreclosed a state prudence review of Grand Gulf 1. This Court reversed the Mississippi Supreme Court, however, and stated that the

> reasoning that led to our decision in *Nantahala* applies with equal force here and compels the same conclusion — States may not alter FERC-ordered allocations of power by substituting their own determinations of what would be just and fair.

MP&L, 487 U.S. at 371.

This Court made clear that the boundaries of the prudence inquiry foreclosed to the state of Mississippi were not to be construed narrowly. The Court noted that the Mississippi Supreme Court had based its opinion on the companion conclusions (1) that state regulation was not automatically prohibited as to those matters unresolved by the FERC and (2) that

> FERC "was never presented with the question of whether the completion of Grand Gulf, or its continued operation, was prudent" . . . and that the Court of Appeals in affirming FERC's allocation had "made no finding with regard to prudency *because the issue was not presented.*"

Id. at 368 (emphasis in original) (citations omitted).

This Court stated in response that the Mississippi Supreme Court had erred in adopting the view that the preemptive effect of FERC's allocation order (Opinion No. 234, *et seq.*) turned on whether the prudence of Grand Gulf 1 had been investigated thoroughly and completely in the evidentiary hearings held before FERC. This kind of case-by-case analysis, which was also employed by the court below, was rejected once more by this Court. *Id.* at 374. Citing *Nantahala*, the Court emphasized its rejection by explaining that the state of Mississippi (just as the Council in the context of the instant case) had been given an unlimited opportunity before the FERC to review all aspects of prudence. Plainly, under the principles of *Nantahala* and *MP&L*, a retail ratemaking authority should not be given the latitude to circumvent the preemptive effect of a FERC-approved allocation by creating a presumably unexplored theory of imprudence for the state to investigate.

With *Nantahala* and *MP&L* so recently decided, how then is it possible for the court to have erred in its decision below? As to NOPSI's facial preemption claim, the answer lies entirely within section II.C. of the court's opinion. 911 F.2d at 1001-02, App. 15A-18A.

That crucial section commences with a statement of the correct principle — "*Nantahala* and *Mississippi Power and Light* reaffirmed the well-established prin-

ciple that if FERC has jurisdiction over a subject, states cannot have jurisdiction over it." *Id.* at 1001, App. 15A-16A. The court, however, goes astray immediately thereafter. It incorrectly assumes that this case presents a rational "variation" of the prudence argument that is not governed by *Nantahala* or even by *MP&L*, despite the latter decision's direct factual and legal relationship to this case.

In fact, the court accepts a variation of the prudence argument that is, in all practical terms, merely a contrivance to evade the broad preemption rule of *MP&L*. Recognizing that *MP&L*

> established that FERC had jurisdiction to determine whether the various utilities [including NOPSI] acted prudently in deciding to participate in the Grand Gulf venture, and that the states [including the Council] were therefore precluded from conducting prudence inquiries on that subject,

911 F.2d at 1001, App. 16A, the court states that the pivotal issue is whether the FERC asserted or had jurisdiction to address whether "NOPSI acted prudently [by minimizing its 'losses'] once the Grand Gulf project was underway." *Id.* Virtually without further ado, the court states (1) that "it is plain that FERC did not assert jurisdiction to determine NOPSI's prudence in not acting to minimize its losses [after the Grand Gulf project was underway]," and (2) that "we must presume" that Congress never intended to preempt the Council from exploring this presumably discrete and severable area of prudence. 911 F.2d at 1002, App. 16A-17A.

It is, however, absurd to divide jurisdiction over the prudence issue involving Grand Gulf 1 between the decision of NOPSI "to participate in the Grand Gulf venture" and NOPSI's behavior "once the Grand Gulf project was underway." If investment in the construction of Grand Gulf 1 was prudent as FERC found, then NOPSI had no "losses" to "minimize"; and since the Grand Gulf project remained a prudent investment throughout its construction period, which did not end until 1985, NOPSI's reliance on diversifying its power sources through the Grand Gulf project was legally prudent. No credence should be given to the proposition that during the Grand Gulf 1 construction period, NOPSI should have attempted to dispose of its then undetermined portion of Grand Gulf 1. As this Court stated in *MP&L*:

> As we assumed, it might well be unreasonable for a utility to purchase unnecessary quantities of high cost power, even at FERC-approved rates, if it had the legal right to refuse to buy that power. But if the integrity of FERC regulation is to be preserved, *it obviously cannot be unreasonable for MP&L to procure the particular quantity of high-priced Grand Gulf power that FERC has ordered it to pay for*. Just as Nantahala had no legal right to obtain any more low cost TVA power than the amount allocated by FERC, it is equally clear that MP&L may not pay for less Grand Gulf power than the amount allocated by FERC.

MP&L, 487 U.S. at 373-74 (emphasis added).

Further, in accord with clear FERC precedent, the FERC would not have approved the wholesale recov-

ery of the investment costs of Grand Gulf 1 in 1985 if any party to the FERC proceedings, including the Council, had demonstrated that by then the prudent, least cost strategy for NOPSI and the other MSU System operating companies was concurrently to sell off their allocations of Grand Gulf 1 and to acquire alternative power supplies.[5] The Council's finding that it should have been apparent in 1980 that Grand Gulf 1 power would be so much more expensive than coal-fired power that NOPSI should have sold off its then-contingent interest in the plant (Petition, at 7 n.5) amounts to an indirect refusal of the Council to accept the FERC's decision in Opinion No. 234, *et seq.*

Having accepted the Council's fallacious minimization-of-losses argument at face value, the lower court attempts briefly to support its presumption that the power to investigate this allegedly variant form of prudence is reserved to the Council. In invoking the "historic police powers" argument, however, the court resorts to the same kind of overly broad and unfocused reasoning that this Court rejected in *Nantahala* and *MP&L* (*e.g.*, *MP&L*, 487 U.S. at 369-70). In both those cases, as in this one, FERC ordered a specific allocation of power; it did not merely set a rate for a source of power that the utility in question legally could or could not purchase in accordance with a power purchasing strategy beyond FERC's domain. Thus, notwithstanding the police powers of a state, the FERC allocation must prevail.

Despite repeated reference to one passage from this Court's opinion in *New Orleans Public Service Inc. v. Council of New Orleans*, 491 U.S. 350, 109 S. Ct.

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[5] See Petition, at 18 n.17, for supporting case citations.

2506 (1989) ("*NOPSI III*"), there is no basis in the passage to excuse the lower court's total breakdown in reasoned analysis. *See* 911 F.2d at 998, 1001, 1003, App. 9A-10A, 15A, 17A. In stating that the Council's action was not "flagrantly" unlawful under the abstention doctrine, this Court did not curtail the substantive reach of either *Nantahala* or *MP&L*, which are in harmony and clearly should control the outcome of this case.[6]

Similarly, the lower court's attempt (911 F.2d at 1002, App. 17A-18A) to support its analytical failure with an analogy to the "perfectly sensible" (106 S. Ct. at 2357) rule of *Narragansett Electric Co. v. Burke*, 381 A.2d 1358 (R.I. 1977) ("*Narragansett*"), is also devoid of merit. First, the lower court misinterprets or misquotes the *Narragansett* rule in stating that a state "may deny [FERC-approved] pass throughs because costs have gone down in other areas . . . ." 911 F.2d at 1002, App. 18A. Whether this statement is inadvertent or otherwise, a state may not deny "pass throughs" of FERC-approved costs because costs have gone down in other areas. Under *Narragansett*, a state has the power to deny or limit the amount of a proposed retail rate increase, despite the requirement to pass through FERC-approved wholesale costs, where the utility's costs in other areas have decreased sufficiently to cancel the effect of the required wholesale cost pass-through.

Second, it is inconceivable that the *Narragansett* doctrine of offsetting a FERC-mandated pass-through of wholesale costs with any cost savings "in other

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[6] The issue in this case was not an issue that was before this Court in *NOPSI III*. 491 U.S. at 350-352.

areas" can be construed to aid either the Council's contrived theory of minimizing losses attributable to Grand Gulf 1 or the lower court's countenance of the theory. "Other areas" clearly means other, discrete cost areas. Thus, in the context of this case, it would refer to such costs, for example, as NOPSI's non-Grand Gulf 1 operation and maintenance expenses or NOPSI's cost of borrowing funds or obtaining equity capital.

Third, in stating that, "it seems logical that [states] should be able to deny [pass-throughs] because costs would have gone down if the utility had not been imprudent," 911 F.2d at 1002, App. 18A, the lower court's logic seems to rest less on *Narragansett* than on the principle of *Pike County Light & Power Co. v. Pennsylvania Public Utility Commission*, 465 A.2d 735 (Penn. Commonwealth Ct. 1983) ("*Pike County*") — that, in the absence of a FERC-approved allocation of power, a state may disallow the costs incurred under a FERC approved rate where a cheaper power source was available. *MP&L* makes clear, however, that the *Pike County* principle is also inapplicable in this case, 487 U.S. at 373-74, where there is an explicit FERC-approved allocation of power. Although the lower court recognized the inapplicability of *Pike County* earlier in its opinion (911 F.2d at 1000, App. 14A-15A), it overlooked this point in the crucial part of its opinion.

Finally, the opinion below is inconsistent with supreme court preemption decisions from the states of Massachusetts, North Dakota and Minnesota that, while decided earlier in time, are entirely consistent with *Nantahala* and *MP&L*. *See Northern States Power Co. v. Hagen*, 314 N.W.2d 32 (N.D. 1981); *Eastern Edison Co. v. Department of Public Utilities*, 446 N.E.2d 684 (Mass. 1983); *Northern States Power Co. v. Minnesota Public Utilities Commission*, 344 N.W.2d 374 (Minn. 1984). These cases clearly establish that the overwhelming weight of judicial authority supports repudiation of the Council's attempt to disallow Grand Gulf 1 costs despite FERC's determination that Grand Gulf 1 should be allocated in its entirety among the MSU System operating companies.

Despite *Nantahala, MP&L* and these cases, if the lower court's decision is affirmed, then other retail ratemaking bodies throughout the country almost certainly will be encouraged to adopt similar rationales for undermining the preemption doctrine as it is meant to be applied in the electric utility industry.

CONCLUSION

The Court should grant the Petition and reverse summarily the opinion below.

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No. 90-1156

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*,
Respondents.

On Petition For Writ Of Certiorari To The United States Court of Appeals For The Fifth Circuit

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-1156

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*,
Respondents.

RESPONDENTS' SUPPLEMENTAL FILING

Pursuant to Rule 15.7, respondents respectfully submit this response to petitioner's supplemental filing of April 6, 1991, which enclosed the decision of the Louisiana Court of Appeals for the Fourth Circuit in a parallel state proceeding (*Alliance for Affordable Energy, Inc. v. Council of the City of New Orleans*, 90-CA-0420), but characterized it in an argumentative and inaccurate manner.

The state court decision found that: (1) the Council's factual findings on the prudence matter were supported not merely by "substantial" evidence but by a "preponderance"; (2) the Council's rate order was not preempted; (3) there were no due process or other violations in the proceedings; (4) there was no commerce clause violation; and (5) the Council erred in

moderating the disallowance by considering its economic impact on NOPSI, so that the disallowance would have to be a larger amount.

The intermediate appellate decision has no immediate effect on petitioner's rates (the subject of the case here), because the decision does not become final for at least 30 days, and the suspense of finality would be automatically extended by a petition for rehearing and by a petition for review by the Louisiana Supreme Court, and until a final decision is rendered or review is finally denied. It may further be suspended pending application for review by this Court. La. Code Civ. Proc. Art. 2166 (West Supp. 1991) (reprinted in the appendix hereto).

Further, while petitioner's letter recites that the state court opinion rejected NOPSI's "facial" preemption claim on *res judicata* grounds, in fact the court conducted an independent analysis of NOPSI's preemption claim (Slip. Op. at 28-31), and found "no merit" in it (*id.* at 31), and only after doing so, as an alternative basis, indicated that *this* Court's prior holding in *NOPSI III* and the Fifth Circuit's decision thereafter rendered the issue *res judicata*. *Id.* at 31.

Finally, petitioner characterizes the opinion as demonstrating the need for the Court to intercede now to reverse the ruling of the Fifth Circuit here; but, in fact, the decision here of an intermediate state court shows that the state courts are responsibly dealing with *all* the issues in this matter, and that the determination of whether there is any need for review

by this Court can and should await the completion of that process.

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APPENDIX

APPENDIX

Louisiana Statutes

La. Code Civ. Proc. Ann. art. 2166 (West Supp. 1991)

A. Within fourteen days of the mailing of the notice of the judgment and opinion of the court of appeal, a party may apply to the court of appeal for a rehearing. Within thirty days of the mailing of the notice of the judgment and opinion of the court of appeal, a party may apply to the supreme court for a writ of certiorari. The judgment of a court of appeal becomes final and definitive if neither an application to the court of appeal for rehearing nor an application to the supreme court for a writ of certiorari is timely filed.

B. If any party files a timely application to the court of appeal for a rehearing, then the time within which any other party may apply to the supreme court for a writ of certiorari shall be extended until thirty days of the mailing of the notice of a denial of rehearing.

C. If a timely application for rehearing has been filed in the court of appeal and the court of appeal denies the application, the judgment becomes final and definitive unless an application for writ of certiorari to the supreme court is filed within thirty days of the mailing of the notice of a denial of rehearing.

D. If an application for certiorari to the supreme court is timely filed, a judgment of the court of appeal becomes final and definitive when the supreme court denies the application for certiorari. The supreme court may stay the execution of the judgment of the court of appeal pending a timely application for certiorari or an appeal to the United States Supreme Court.

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(7)

No. 90-1156

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, JOSEPH I. GIARRUSSO, LAMBERT C. BOISSIERE, JR., MICHAEL EARLY, JAMES SINGLETON, DOROTHY MAE TAYLOR, JOHNNY JACKSON, and PEGGY WILSON,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-1156

NEW ORLEANS PUBLIC SERVICE INC.,

Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*,

Respondents.

PETITIONER'S SUPPLEMENTAL FILING PURSUANT TO RULE 15.7

Pursuant to Rule 15.7, petitioner NOPSI respectfully brings to the Court's attention a decision by the Louisiana Court of Appeal for the Fourth Circuit that is relevant to the federal question presented in this case. This decision was released on April 4, 1991 in the parallel state proceeding between the parties, and it orders the disallowance—and "trapping"—of an *additional* $290.38 million of NOPSI's FERC-mandated Grand Gulf costs. The Louisiana opinion is reproduced in the Appendix to this filing.

In its decision, the Louisiana court rejected NOPSI's federal preemption claims on the ground that the Fifth Circuit's decision here under review (and this Court's earlier abstention decision in this case) are *res judicata* on these issues. App. 29A-30A. The Louisiana Court further held that, as a matter of Louisiana state utility law, the Council was required to disallow the entire $476.58 million of NOPSI's FERC-mandated Grand Gulf costs that the Council found to have been imprudently incurred, rather than the $186.2 million that the Council in fact disallowed. App. 38A-47A. Because these amounts include the $51.2 million that NOPSI absorbed in an earlier settlement agreement, the Court's

decision would increase the prudence disallowance at issue here from $135 million (plus carrying charges) to $425.38 million (plus carrying charges).

The Louisiana Court of Appeal's state law ruling is subject to further discretionary review in the Louisiana courts. However, this ruling demonstrates that, unless this Court reverses the Fifth Circuit's federal preemption decision, there is no limit on the extent to which state utility law can be applied to interfere with interstate power pools and the individual participating utilities, contrary to *MP&L* and *Nantahala*. Indeed, the Council previously found that this $425.38 million disallowance would not merely render NOPSI "unable to pay" its "FERC-determined allocation;" it "would cause NOPSI to become insolvent and force its bankruptcy." Council Order, p. 12. *Compare MP&L*, 487 U.S. 354, 365-68 (1988) ("MP&L would become insolvent if [rate] relief were not granted").

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APPENDIX

1A

ALLIANCE FOR AFFORDABLE ENERGY, INC., ET AL

versus

THE COUNCIL OF THE CITY OF NEW ORLEANS
Consolidated With
LAMBERT BOISSIERE, JR., ET AL

versus

JAMES M. CAIN, ET AL
Consolidated With
NEW ORLEANS PUBLIC SERVICE INC.

versus

THE COUNCIL OF THE CITY OF
NEW ORLEANS, ET AL

NOS. 90-CA-0420
c/w
90-CA-0421
c/w
90-CA-0422

COURT OF APPEAL, FOURTH CIRCUIT
STATE OF LOUISIANA

Appeal from Civil District Court, Parish of Orleans
Division D, Nos. 88-2502, 88-2503 and 88-4511
Honorable Louis A. DiRosa, Judge

Steven R. Plotkin
Judge

(Court composed of Judges Joan Bernard Armstrong,
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FOR APPELLEE, The Council of the City of New Orleans

Affirmed in Part
Reversed in Part
Amended in Part

These two consolidated appeals present complex state and federal questions. The ultimate questions are: (1) whether New Orleans Public Service, Inc. (NOPSI) acted prudently or imprudently in its oversight and management of its participation in the construction project of the Grand Gulf I nuclear power plant, and (2) who should bear the excessive cost overruns of this project, the ratepayers/consumers of New Orleans or the stockholders of NOPSI.

New Orleans Public Service and the Alliance for Affordable Energy (Alliance) have each appealed the rate order decided by the New Orleans City Council (Council) on February 4, 1988, and its Reasons For Judgment, entitled "Prudence Investigation: Determinations and Order Regarding the Prudence of the Management of New Orleans Public Service, Inc. With Respect to Grand Gulf I." The rate order decision was affirmed by the civil district court of the Parish of Orleans.

The New Orleans City Council is the ratemaking body for the City of New Orleans. Under the City's Home Rule Charter, Section 4-1604, the Council is invested with "all powers of supervision, regulation and control over any" public utility within the City. The authority of the Home Rule Charter is recognized by the Louisiana Constitution, Art. 6, Section 5(E).

The Council found that approximately 31% of these costs, or $476 million, had been imprudently incurred. After considering the financial effects of a prudence disallowance on NOPSI, the Council decided not to permit $135 million of these imprudently incurred costs to be passed on to the ratepayers of New Orleans.

NOPSI has appealed this decision, contending that all its Grand Gulf costs should be passed on to the ratepayers. The Alliance has also appealed, contending that the entire amount of costs found to be imprudent should be disallowed from passthrough to the ratepayers.

The History

This litigation has a long and convoluted history in both state and federal court. The history was most recently summarized as follows by the U.S. Fifth Circuit in *NOPSI v. The Council of the City of New Orleans,* 911 F.2d 993 (5th Cir. 1990) (*NOPSI IV*):

> NOPSI is a producer, wholesaler, and retailer of electricity, providing its retail services to the city of New Orleans.[1] Along with Arkansas Power and Light [AP&L], Mississippi Power and Light [MP&L], and Louisiana Power and Light [LP&L], it is a wholly owned operating subsidiary of Middle South Utilities, Inc. [now known as Entergy Corporation]. MSU operates an integrated 'power pool' in which NOPSI and the three other power companies transmit the electricity they produce to a central dispatch center, and each draws back the power it needs to meet customer demand.

[1]Except the area called Algiers, which is serviced by LP&L.

> Through the 1950's and into the 1960's, most of the MSU system's generating plants were fueled with oil or gas. In the late 1960's, MSU sought to meet projected increases in demand by adding coal-fired and nuclear energy powered generating plants. Originally, MSU planned for each of the power companies to construct one or more nuclear facilities. Mississippi Power and Light was charged with constructing two plants at Port Gibson, Mississippi, to be known as Grand Gulf 1 and 2. The Grand Gulf project quickly proved too burdensome for one company, however. MSU created another subsidiary, separate from the power companies, known as Middle South Energy, Inc.[2] [MSE, which is now known as Systems Energy Resources, Inc., or SERI] to finance, own, and operate the Grand Gulf plants. In 1974, MSE in turn contracted with the power companies to finance the project. The companies agreed to pay for the construction of the plants in exchange for the right to [purchase] their output. The estimated construction cost at that time was $1.2 billion.
>
> As the project progressed, consumer demand for electric power proved to be much lower than MSU and the power companies had expected. At the same time, regulatory delays, enhanced construction requirements resulting from the Three Mile Island accident, and high inflation led to spiraling costs on the Grand Gulf project. As a result, MSE suspended construction of Grand Gulf 2, although it continued to build Grand Gulf 1. The cost of completing Grand Gulf 1 alone eventually exceeded $3 billion.[3]

911 F.2d at 995-96 (footnotes omitted).

[2]The Board of Directors of MSE is composed of the presidents of the MSU operating companies and the president of MSU. MSE owns 90% of Grand Gulf I. Southern Mississippi Electric Power Association owns the other 10%. Technical services were provided by another MSU subsidiary, Middle South Services, Inc. (MSS).

[3]When Grand Gulf I became operational in July 1985, the construction costs totalled approximately $3.654 billion, or approximately $3 billion more than the original estimate of $600 to 800 million, an increase of 450% to 600%.

In late 1979, before Grand Gulf I became operational and before its costs were known, NOPSI applied to the Council for a "capacity adjustment clause" which would authorize an automatic pass-through of future Grand Gulf construction costs to its ratepayers. In January 1980, nine months after the Three Mile Island accident, but before the Council acted on the application, NOPSI made a voluntary commitment to a 29.8% share of Grand Gulf, although its actual consumption need was approximately 9%. NOPSI failed to inform the Council of its commitment to the Grand Gulf project until 1980 when it applied for the pass-through of costs to the ratepayers. The Council held hearings in May and September 1980, but declined to adopt the capacity adjustment clause.

> The power companies considered various methods to allocate the cost of Grand Gulf in light of these developments. In 1982, MSU filed a Unit Power Sales Agreement with the Federal Energy Regulatory Commission [FERC], which set out the shares of Grand Gulf 1 output each company was required to purchase in order to pay construction costs. Arkansas Power and Light, which had finished its own nuclear plants, was not obligated to purchase any Grand Gulf power. Louisiana Power and Light, which had not finished its plant, was obligated to purchase 38.57%. Mississippi Power and Light was obligated to purchase 31.63%, and NOPSI 29.8%. MSU also filed a new System Agreement with FERC, which set forth the terms and conditions for coordinated operations and wholesale transactions among the four companies, but did not deal with the Grand Gulf costs.
>
> FERC assigned the agreements to two separate Administrative Law Judges for the statutorily required task of determining whether they were just and reasonable. Both judges held that the failure to distribute the Grand Gulf costs among all the members rendered the agreements unduly discriminatory; ALJ Head further held that these costs should be allocated in proportion to each company's relative system demand. *Middle South Services, Inc.*, 30 F.E.R.C. #63,030, pp. 65,170-65,173 (1985) (System Agreement); *Middle South Energy, Inc.*, 26 F.E.R.C. #63,044, pp. 65-105-65,108 (1984) (Unit Power Sales Agreement) (ALJ Head). FERC consolidated the proceedings for review, and determined that an adjustment of the shares allocated in the Unit Power Sales Agreement was all that was necessary to render both agreements just and reasonable. FERC reduced NOPSI's share from 29.8% to 17%.

911 F.2d at 996 (footnotes omitted). The FERC allocations were affirmed on rehearing. *Mississippi Industries v. FERC*, 808 F.2d 1525, modified on rehearing 822 F.2d 1104 (D.C.Cir.), *cert. denied*, 108 S.Ct. 500 (1987); *City of New Orleans v. FERC*, 875 F.2d 903 (D.C.Cir. 1989), *cert. denied sub nom. Mississippi v. FERC*, 110 S.Ct. 1805 (1990).

After Grand Gulf became operational in July 1985, NOPSI filed an application with the Council to recover its construction and operating costs from the ratepayers, which would have resulted in an immediate 60% increase in retail utility rates. The Council denied an immediate rate increase, although it offered NOPSI interim rate relief. NOPSI rejected this offer and filed suit in federal court against the City, its mayor, and against the City Council collectively and its members individually. The district court dismissed the suit, holding that under the Johnson Act, 28 U.S.C. #1342, it lacked jurisdiction to proceed. The court further noted that if it did have jurisdiction, it would have abstained pursuant to *Burford v. Sun Oil, Co.*, 319 U.S. 315, 63 S.Ct. 1098, 87 L.Ed. 1424 (1943). The Fifth Circuit reversed, but then withdrew its original opinion and affirmed on rehearing, finding that abstention was proper under *Burford* and under *Younger v. Harris*, 401 U.S. 37, 91 S.Ct. 746, 27 L.Ed.2d 669 (1971). *NOPSI v. The City of New Orleans*, 782 F.2d 1236, *modified on rehearing*, 798 F.2d 858 (5th Cir. 1986)(*NOPSI I*).

On October 10, 1985, the Council passed a resolution undertaking an investigation into the prudence of NOPSI's participation in the Grand Gulf project and the resulting costs incurred, as well as NOPSI's efforts to minimize such costs. NOPSI filed a

second suit in federal district court, attempting to enjoin the Council from holding the hearings and preventing the pass-through of costs. The district court dismissed on grounds of ripeness, and in the alternative abstained. The Fifth Circuit affirmed on the issue of ripeness. *NOPSI v. The Council of the City of New Orleans,* 833 F.2d 583 (5th Cir. 1987) (*NOPSI II*).

In March 1986, the Council entered into a partial settlement with NOPSI under which NOPSI agreed to absorb $51.2 million of the Grand Gulf costs, and the Council allowed NOPSI to phase in an interim rate increase, subject to the results of the Council's prudence investigation.

The Council held hearings on the question of prudence from March 4, 1986, through February 24, 1987. In addition, the Council accepted into the record prepared testimony, depositions and reports made by expert witnesses. In April 1987, the Council completed the record of its investigation and began deliberations, which NOPSI attempted to prevent by seeking an injunction from the federal district court. This request was later dropped by NOPSI.

The Council completed its extensive investigation and issued a final rate order on February 4, 1988. The investigation concluded that, at a minimum, NOPSI was imprudent in incurring approximately 31%, about $476 million, of Grand Gulf's $1.567 billion total costs to New Orleans, and that it had done virtually nothing to assess or minimize its risks. The rate order found "that NOPSI's management failed to protect the interests of its ratepayers, and the company's conduct fell short of prudent utility management, to the detriment of its ratepayers and shareholders." Fearing that disallowance of the entire amount would force NOPSI into insolvency, the Council made a one-time imprudence deduction of $150 million, which, on the basis of further caution, it reduced to $135 million. The Council thus disallowed the pass-through of only $186.2 million (the $135 million disallowed as

imprudent and the $51.2 million which NOPSI agreed not to pass through to retail rates in the partial settlement) of the imprudently incurred Grand Gulf costs to the ratepayers, and allowed the remainder of these imprudently incurred costs (approximately $290 million) to be passed on to the ratepayers.

NOPSI then filed complaints against the rate order in state and federal court. In federal district court, NOPSI argued that the Council could not prevent the pass-through of any Grand Gulf costs because this issue was preempted by federal law under *Nantahala Power and Light Co. v. Thornburg,* 476 U.S. 953, 106 S.Ct. 2349, 90 L.Ed.2d 943 (1986). The district court abstained under *Burford* and *Younger* and the Fifth Circuit affirmed its abstention. *NOPSI v. Council of New Orleans,* 850 F.2d 1069 (5th Cir. 1988), *cert. granted,* 488 U.S. 1003, 109 S.Ct. 780, 102 L.Ed.2d 772 (1989). The Supreme Court reversed, finding abstention improper on both grounds, but holding that the Council's actions were not preempted by federal law. *NOPSI v. Council of City of New Orleans,* 109 S.Ct. 2506, 2517, 105 L.Ed.2d 298 (1989) (*NOPSI III*). On remand, NOPSI again argued that the Council's order was preempted on its face and that the Council was attacking the FERC allocation. The federal district court ruled that the order was not facially preempted, and stayed the pretext issued pending resolution of the litigation in the state courts. The Fifth Circuit affirmed. *NOPSI v. Council of the City of New Orleans,* 911 F.2d 993 (5th Cir. 1990) (rehearing denied October 17, 1990) (*NOPSI IV*).

NOPSI appealed the Council's rate order in the Civil District Court of the Parish of Orleans. This state court action was filed by NOPSI simultaneously with its federal *NOPSI III* suit. NOPSI's appeal was consolidated with two other suits, one filed by the Council seeking a declaratory judgment on the validity of its rate order, and one by consumer advocates Alliance for Affordable Energy, Citizens for Safe Energy, and Gary L. Groesch,

challenging the disallowance of only $135 million of the $476 million in costs that the Council had found to be imprudently incurred.

The district court upheld the rate order of the Council, affirmed its validity, and denied the petitions of both NOPSI and Alliance. The district court held that the rate order's findings were not preempted by federal law, and that its disallowance of imprudent costs was just and reasonable and supported by substantial evidence.

THE APPEAL OF NOPSI

The Issues Raised by NOPSI

The issues raised by NOPSI that are pertinent to our resolution of this case are as follows:

1. a. Did the district court apply the correct standard of review to the Council's findings of fact and conclusions of law?

b. Did the district court correctly allocate the burden of proof to the proper party?

c. Is there substantial evidence to support the Council's finding of imprudence on the part of NOPSI?

2. Is the Council's rate order preempted by federal law?

3. Is the Council's rate order a pretext for an impermissible collateral attack on the allocations made by FERC?

4. Did the Council's rate order violate the commerce clause of the U.S. Constitution (Art I, sec. 8)?

5. Was NOPSI denied due process or meaningful judicial review by the Council when it utilized its legal and technical staff for the preparation of the rate order?

1. *THE SUFFICIENCY OF THE EVIDENCE*

a. Standard of Review

The Civil District Court of Orleans Parish is the proper court designated to review a City Council rate order regulating utility

rates. New Orleans Home Rule Charter, Section 4-1604. Under the Louisiana Administrative Procedure Act, LSA-R.S. 49:964 (G), the district court must affirm an agency decision, unless substantial rights of the appellant have been prejudiced because the administrative decision was:

> (1) In violation of constitutional or statutory provisions;
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> (2) In excess of the statutory authority of the agency;
>
> (3) Made upon unlawful procedure;
>
> (4) Affected by other error of law;
>
> (5) Arbitrary or capricious or characterized by abuse of discretion . . .; or
>
> (6) Manifestly erroneous in view of the reliable, probative, and substantial evidence on the whole record.

The City Council issued its rate order under the authority of the Louisiana Constitution, Art. VI, Section 5, and of its Home Rule Charter, Section 4-1604. The Council did not violate constitutional or statutory provisions or exceed its statutory authority. Its decision was made upon lawful procedure and was not affected by error of law.

NOPSI contends on appeal that the district court erred in applying the "arbitrary and capricious" standard or review. Generally, the "manifest error" test is used in reviewing the facts found by an agency and the "arbitrary and capricious" test is used in reviewing an agency's conclusions and exercises of discretion. *Save Ourselves, Inc. v. Louisiana Environmental Control Commission*, 452 So.2d 1152, 1159 (La. 1984).

The Civil District Court summarized its standard of review thus: to determine whether the facts "are supported by substantial evidence in the record and are rationally based." Slip opin. at 4. The court then cited the above section of the Louisiana Administrative Procedure Act. LSA-R.S. 49:964(G). The arbitrary

and capricious standard is the same as that of rational basis. "Arbitrariness is the absence of a rational basis." *Graffeo v. City of New Orleans,* 351 So.2d 1311, 1314 (La. App. 4 Cir. 1977).

The Louisiana Supreme Court has applied a standard of reasonableness to appellate review of utility rate decisions:

> A reviewing court will not substitute its judgment for that of the [ratemaking body] in fixing public utility rates, and the agency's rate order will be upheld unless shown to be arbitrary, capricious, abusive of its authority, clearly erroneous or unsupported by evidence. See *So. Cent. Bell Tel. v. L.P.S.C.,* 352 So.2d 964 (La. 1977).

Cent. La. Elect. Co. v. La. P.U.C., 437 So.2d 278, 279 (La. 1983).

The Louisiana Supreme Court has specifically articulated the standard of appellate review of Council rate decisions.

> [T]he Council of the City of New Orleans is vested with the sole legal authority to regulate the rates charged by companies furnishing utility services in the city of New Orleans. Recognition of that authority requires that we limit our review to a determination of whether the [decision] is reasonable and refrain from merely substituting our judgment for that of the Council.

State ex rel. Guste v. Council of City of New Orleans, 309 So.2d 290, 294 (La. 1975), cited with approval, 109 S.Ct. 2506, 2520 (1989).

This court has reviewed the record to determine whether there is substantial evidence to support the facts found by the Council, and has applied a standard of reasonableness to review the Council's conclusions of law. The burden of proving that a rate order is arbitrary or unreasonable is on the party attacking the order. *Dixie Elect. Mem. v. La. P.U.C.,* 441 So.2d 1208, 1210 (La. 1983). Thus NOPSI must demonstrate that the Council's fact findings are not supported by substantial evidence and that its conclusions are unreasonable.

b. Burden of Proof for Prudence

NOPSI contends that the trial court improperly found that the burden of proof was on NOPSI to show that its actions were not imprudent. NOPSI cited a footnote to the concurrence in *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission of Missouri,* 262 U.S. 276, 289, n.1, 43 S.Ct. 544, 549, n.1, 67 L.Ed.2d 981 (1923) (Brandeis, J., concurring), which stated that "[e]very investment may be assumed to have been made in the exercise of reasonable judgment, unless the contrary is shown."

The trial court held that there was an initial presumption of prudence on the part of the utility, but that, once this presumption is rebutted, the burden of proof then shifted to the utility to prove the prudence of its expenses. In *Minnesota Power & Light Co.,* 11 FERC 61,312, at 61,644-45 (1980) FERC held that the burden shifted at the point where serious doubt about the prudence of an expenditure arose.

> A 'doubt' is created if the challenge raises a question the answer to which is not arguably in favor of prudence. A doubt is 'serious' if there appears at least a possibility that, upon due investigation, the answer to the question will lead to a finding against prudence.

New England Power Co., 27 FERC #63,037, at 65,157 (1984), *rev'd on other grounds,* 31 FERC #61,047 (1985).

In the instant case, the trial court found that the burden of proof had shifted to NOPSI. Serious doubts concerning NOPSI's prudence were raised through testimony which established that NOPSI voluntarily accepted an excessive share of Grand Gulf even though it did no studies on Grand Gulf costs, that NOPSI could and should have sold at least part of its Grand Gulf power off system, and that NOPSI could and should have purchased coal fired power. The burden of proof then shifted from the Council to NOPSI, which then had to prove that its actions were not

imprudent. The trial court found that NOPSI failed to meet this burden of proof. We agree with the trial court's legal analysis and find no merit to NOPSI's contention.

A working definition of the term "prudence" is helpful in the analysis of this issue. NOPSI proposed the following definition which was cited in the Council rate order: "whether the utility followed a course of conduct that a capably managed utility would have followed in light of existing and reasonably knowable circumstances." *In Re Seabrook Involvements by Maine Utilities,* 67 P.U.R. 4th 161, 166 (Maine P.U.C., 1985). See Rate Order at 34. In the seminal words of Justice Brandeis, the prudence test "is applied for the purpose of excluding what might be found to be dishonest or obviously wasteful or imprudent expenditures." *Missouri, supra,* at 549, n.l.

c. The Sufficiency of the Evidence

The rate order of the Council incorporates the 224 page "Determinations and Order" as its formal findings of fact and conclusions. In this document, the Council, as decision-maker, specified in detail its reasons for making its ruling, including its factual findings and credibility decisions. This document was unanimously adopted by the Council as its final order and decision.

The findings of the Council, as stated in the rate order, are as follows:

> 1. In 1974 NOPSI made a commitment to an indeterminate share of Grand Gulf costs without limiting its liability.
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> 2. The oversight and review by NOPSI management of its Grand Gulf involvement, especially during 1979-80, was uncritical, severely deficient, and less than prudent.
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> 3. NOPSI management should have been aware of the escalation of nuclear power plant costs, especially after Three Mile Island in March 1979. Its 1980 commitment to a 29.8% share of Grand Gulf, a share which FERC later found to be excessive, was grossly imprudent.

> 4. NOPSI should have sold off system its share of Grand Gulf power over and above its 9% actual need. The share over and above the actual need should be passed through in retail rates only at the cost level of coal fired power. This would result in an approximately 31% reduction in the amount of Grand Gulf costs which NOPSI could pass through to retail ratepayers.
>
> 5. Disallowance of the full amount of imprudently incurred costs could cause NOPSI to become insolvent. NOPSI could, however, withstand an imprudence disallowance of $150 million, which the Council chose to further reduce by ten percent to $135 million on the basis of caution.
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> 6. There shall be no further disallowances for imprudence relating to the Grand Gulf project. The Council will consider future applications for rate relief based upon legitimate costs and applications for financing to fund operations. The Council assures debt and equity investors in NOPSI of the safety of their investments.
>
> 7. These findings are without prejudice to other pending litigation and may be reviewed in the event of a new wholesale cost allocation by FERC or significant change in financial conditions.

Rate Order at 9-13.

NOPSI does not question the first finding, that in 1974 it made an indeterminate commitment to purchase Grand Gulf power, the fifth finding, that the disallowance was reduced in the interest of NOPSI's financial situation, the sixth finding, that the Council will make no future disallowances for imprudence, and the seventh finding, that the findings are without prejudice to pending litigation and may be reviewed in the event of a significant change in financial conditions. These findings are not at issue before this Court.

In its appeal NOPSI challenges the second finding, that its management and oversight of Grand Gulf was deficient, the third finding, that it should have been aware of cost escalations in

nuclear power plant construction, and the fourth finding, that it should have sold its high priced nuclear power off system and bought lower priced coal fired power instead, and that the difference in cost between the two should be disallowed from pass-through to the ratepayers. NOPSI frames its assignment of errors on appeal thus: that the Council failed to prove that it could or should have foreseen the escalation of costs of the Grand Gulf project, that it had an opportunity to sell off a portion of its share of Grand Gulf power, that it had an opportunity to buy coal fired power, and that a sell-off of nuclear power would have resulted in savings.

Extensive hearings were conducted by the Council in 1986 and 1987 on the issue of NOPSI's prudence in incurring liability for the costs of Grand Gulf. These hearings included submission of prepared testimony by and depositions of experts and cross-examination of witnesses by all parties.

i. The Foreseeability of and Failure to Monitor Cost Escalation

NOPSI has the burden to prove that it did monitor Grand Gulf costs in a prudent manner, and that cost escalation of the Grand Gulf project was not foreseeable.

The evidence in the record shows that NOPSI had no personnel and no organizational procedures for monitoring or reviewing information about Grand Gulf costs, or for investigating or challenging escalating costs.

Four members of the NOPSI Board of Directors testified that they could not recall that any studies were ever presented or discussed at NOPSI board meetings concerning the escalation of Grand Gulf construction costs, especially during the crucial years 1979-80 immediately following the Three Mile Island accident. This lack of study or discussion was confirmed by William Talbot, the secretary of NOPSI, on review of the minutes of the board meetings. NOPSI officials, including its president, James Cain, its senior vice president and general manager, Malcolm Hurstell, its senior vice president and treasurer, Malcolm McLetchie, its comptroller, John Chavanne, and its former comptroller, August Brodtmann, all testified that they did not recall any studies conducted by NOPSI concerning the escalation of construction costs for nuclear power or the alternative sources of power which would reduce NOPSI's risk. NOPSI did, on the other hand, conduct studies during this period on issues such as internal computerization and its decision not to build the Alligator Point nuclear plant.

The evidence shows that NOPSI never held a meeting or commissioned a study to discuss the costs implications of the Three Mile Island accident in March 1979 for the Grand Gulf project. Instead NOPSI voluntarily acceded to purchase an excessively large share of Grand Gulf power in January 1980. This share, 29.8%, was disproportionate to the relative size of NOPSI in terms of its consumption within the MSU system which was 9%. In 1985 FERC found this share to be excessive and reduced it to 17%. At the same time, NOPSI did nothing to oppose the decision of another MSU company, AP&L, to take no share of Grand Gulf power. In addition, under the Availability Agreement, NOPSI was obligated to pay for its entire share of Grand Gulf whether the plant was operational or not.

NOPSI contends that it had no responsibility or obligation to monitor Grand Gulf costs, since it is part of the MSJ system. Planning for the Grand Gulf project was accomplished through the MSU operating committee and MSE, with MP&L overseeing the actual construction. NOPSI claims that it was informed of cost developments through its president, James Cain, and its senior vice president, general manager, and representative on the MSU operating committee, Malcolm Hurstell. Cain admitted that no personnel at NOPSI were responsible for critical review

or analysis of Grand Gulf cost estimates. Cain testified that he relied on Hurstell. Hurstell testified that he obtained his information from Cain, who informed him about the construction schedule for Grand Gulf, but only occasionally mentioned the costs. However, Hurstell admitted that, as a member of the MSU Operating Committee, he received information from various government and industry sources concerning cost escalation in nuclear power plant construction. Hurstell admitted that in January 1980 he had knowledge that the Grand Gulf cost increases could be open-ended. However, he chose to rely on other, lower, cost projections, and did not inform the NOPSI board about the possibility of higher costs.

In the 1980s, Cain was president of both NOPSI and LP&L. In addition, NOPSI and LP&L held joint board meetings. Hurstell testified that these two companies did not have identical interests during the critical period of Grand Gulf planning, that is, between 1979 and 1985. It may be inferred that NOPSI and AP&L also did not have identical interests, since AP&L tried to opt out of nuclear altogether, while NOPSI opted to take a very large share of nuclear power. Yet NOPSI did nothing to represent or safeguard its own interests over against the other MSU companies. NOPSI never convened any committee or Board meeting to discuss the impact of the escalation of Grand Gulf costs on NOPSI ratepayers. FERC eventually decided that the MSU allocations of Grand Gulf, giving 29.8% to NOPSI, the smallest company in the system, and exempting AP&L from any portion, were inequitable and improper.

Thus it was imprudent for NOPSI to rely on and acquiesce without objection in the decisions of the directors and operating committee of MSU without conducting any investigative studies concerning the impact of Grand Gulf costs on NOPSI and its ratepayers during the course of its decision making and oversight of NOPSI's involvement in the Grand Gulf project.

NOPSI now raises a "system defense," claiming that it had no responsibility to make independent studies or conduct discussions, since it was part of the MSU system which made decisions for the system as a whole. Although NOPSI now urges this system defense, the record is replete with tactical decisions by NOPSI to block inquiries by the Council into the circumstances of MSU during the critical period in question. NOPSI objected to and declined to permit discovery questions or requests for document production concerning the management of the other companies within MSU or the MSU system itself. On the other hand, NOPSI produced selective system documents, witnesses and evidence to justify its own positions. Rate Order at 20-26. One example is NOPSI's refusal to allow its president, Cain, to answer questions during the hearings concerning consultations with officers or directors of other MSU companies or of MSU itself, despite the fact that Cain was president of two of those companies and a member of the MSU Board of Directors.

Since NOPSI refused to allow discovery of critical information concerning the MSU system and its other operating companies, while producing selective information for its own benefit, NOPSI cannot claim this defense as justification for its actions or for its failures to act. By its own pre-hearing and hearing conduct on this issue, NOPSI has waived this defense.

Moreover, as a result of NOPSI's blocking of the introduction of evidence relating to the MSU system, there is insufficient evidence in the record for this court to review NOPSI's system defense. NOPSI's own tactics have effectively prevented both the hearing agency and this court from examining the management, practices and policies of MSU and its other operating companies during the time period in question in order to ascertain whether NOPSI's conduct was in fact legitimately controlled by MSU. Therefore NOPSI cannot now claim its membership in the MSU system as a defense to its imprudence.

NOPSI further claimed that it had no responsibility to oversee costs since FERC would assign it reasonable rates. This disclaimer is contradicted by the U.S. Supreme Court which has held that "a utility's purchase of a particular quantity of high cost power at FERC-approved rates might be unreasonable, if lower cost power were available from another sources [*sic*]." *NOPSI IV*, 911 F.2d at 1000, citing *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. at 972, 106 S.Ct. at 2360.

The Council found NOPSI imprudent for failing to do anything to reduce its financial risks in the light of the escalation of Grand Gulf construction costs. The Council made it clear that it was not challenging the share of Grand Gulf allocated by FERC, but rather NOPSI's negligent management and its failures to protect the interests of its ratepayers and its stockholders.

NOPSI also contends that the escalation in Grand Gulf costs was unforeseeable. However, by 1978, the projected construction costs of Grand Gulf had already doubled. After the disaster at Three Mile Island in March 1979, studies on the nuclear power industry, and specifically on the necessity for stricter safety standards, were being conducted across the United States. These studies were reported by the news media. The U.S. Congress held hearings on the subject. Some utility companies, including one member of the MSU system, AP&L, chose to opt out of nuclear power plant projects altogether. In 1980, MSU issued an Annual Report entitled "Nuclear Power in the Post-Three Mile Island Era." This report discussed the Three Mile Island accident, noting safety factors in nuclear power plant operation, medical risk factors, nuclear waste disposal problems, and other issues, but failed to disclose the impact on construction and operating costs. The report also clearly described the wisdom of diversification between nuclear and coal fired power. It is inconceivable that prudent utility management in NOPSI could have been unaware of the cost implications of Three Mile Island for nuclear power plant construction at this time.

NOPSI cites the decision in *Mississippi Industries v. F.E.R.C.*, 808 F.2d 1525 (D.C. Cir. 1987), in support of its contention that the cost escalation was unforeseeable. The D.C. Circuit stated: "[i]t seems unlikely that, in 1979, the companies could have foreseen that the cost of completing Grand Gulf would quadruple . . ." *Id.* at 1555. However, the preceding sentence refers to that period in 1979 when negotiations were taking place in the MSU operating committee concerning the percentages of Grand Gulf that each company would take. As a result of these negotiations, AP&L took 11.11% and NOPSI 25.78%. *Id.* at 1533, and 1533, n.25. By 1980, AP&L had withdrawn completely and NOPSI's share had been increased to 29.8%. NOPSI's citation out of context of this statement by the D.C. Circuit does not constitute evidence that in late 1979, as well as 1980 and 1981, NOPSI could not have foreseen a substantial escalation in Grand Gulf costs.

NOPSI contends that the estimates of Grand Gulf costs which it received during this period were prepared for MSE by the Bechtel Corporation using the "engineering cost estimation" method. This method forecast minimal cost increases. NOPSI claims that this was the standard method used in the industry at the time. However, its general manager, Hurstell, admitted that other utilities commonly used an alternative method, regression analysis, for load forecasting in 1979.

The Council rate order relied on the regression analysis method used by witness Charles Komanoff. NOPSI claimed that this method was not used in the nuclear power industry in 1979. However, studies based on this method had been published as early as 1974 by researchers at Harvard Business School and M.I.T. In addition, studies using this method were published in 1978 by the Department of Energy and in 1979 by the Rand Corporation. NOPSI's complaint that the book of Charles Komanoff, a primary expert witness in the Council hearings, was not published until 1981, has no merit. The record shows that

Komanoff had published the results of his analysis of nuclear plant capital cost trends in an article in a widely read industry journal in 1978, that drafts of his book were circulated in 1978-79, and that he testified using this method in publicly reported hearings before the House Interior Committee in 1979. The Council noted that the regression analysis method was a "widely accepted technique," which, in contrast to the method preferred by NOPSI, "utilized hard data from completed nuclear plants to measure the actual rates of increase in costs during the period and to produce estimates of the effects on costs of various causal factors." Rate Order at 135. NOPSI's critique of the Council's reliance on the regression analysis method has no merit.

Although NOPSI contends that the escalation of Grand Gulf costs was unforeseeable, especially during the period 1979-80, following the Three Mile Island catastrophe, NOPSI does not contest the fact that it appeared before the Council in May 1980, asking the Council to approve a "capacity adjustment clause," which would authorize the automatic pass-through to ratepayers of all Grand Gulf costs, whatever they turned out to be. This action indicates that NOPSI was sufficiently concerned about Grand Gulf costs in 1980 to petition the Council for a "blank check" to avoid the adverse impact of such costs on itself. NOPSI cannot now deny that it could have had any foreknowledge of the magnitude of Grand Gulf cost escalation.

We find substantial evidence to affirm the Council's findings on the issues of negligent management and the foreseeability of Grand Gulf costs.

ii. Off System Sales

The Council identified two positive steps not taken by NOPSI which a prudent manager could and should have taken: (1) that NOPSI could and in prudence should have sold part of its Grand Gulf allocation of nuclear power with its resulting construction

costs off system to other utility companies, and (2) that NOPSI should have replaced this power with less expensive coal fired power. NOPSI carries the burden of proving that its failure to pursue off system sales of its Grand Gulf power was prudent.

NOPSI contends selling Grand Gulf power off system was impossible because there were no actual willing purchasers for its nuclear power. However, the president and CEO of NOPSI, James Cain, testified under oath before the City Council in 1980, when asking for an automatic pass through of Grand Gulf costs to the ratepayers of New Orleans, that the Council should not be concerned about the large share of Grand Gulf (29.8%) to which NOPSI had then just committed itself, because NOPSI could always sell part of its share to other companies. Cain stated that NOPSI would handle the costs derived from its Grand Gulf commitment either by pass through to the ratepayers or by selling its capacity off system. Cain, 1980 Testimony to Council, at 50. He also stated that if, in the future, the Council became opposed to its Grand Gulf involvement, it would have the option of selling its share "to some other buyer." *Id.* at 43-44. Cain stated: "NOPSI has the option of selling this capacity and marketing it, which we think will be a very attractive commodity to other electric utilities." *Id.* at 30-31. Such a formal statement of the possibility of risk reduction by off system sales made by the chief executive officer of the company under oath before the ratemaking body constitutes convincing evidence and must be considered an admission that such sales were feasible at that time. NOPSI cannot now retract the statement and argue the opposite.

NOPSI's contention that structuring and legal problems would make off system sales impossible is contradicted by the evidence of the System Agreement and the offer of such power to 57 other utility companies in 1982. In addition, Regis Trumps, vice president for planning of Middle South Services and secretary of the MSU operating committee, testified that under the System Agree-

ment the individual companies could sell power off system. In 1982 this agreement was amended to give other companies within the system the right of first refusal. Trumps also testified that AP&L, LP&L and MP&L all had wholesale customers for their excess power. He could not recall that NOPSI ever tried to sell off system. Malcolm Hurstell testified that he was aware of Cain's testimony to the Council in 1980 and also stated that NOPSI could have marketed Grand Gulf power in 1980. He stated that in 1982 MSU acted as agent for NOPSI and the other MSU companies in an attempt to sell their Grand Gulf power off system, but by then it was unmarketable.

In the light of the above evidence, NOPSI clearly has not carried its burden of proof to show that its failure to make off system sales of Grand Gulf power was prudent or that such sales were impossible.

iii. Purchase of Coal Fired Power

The Council found that NOPSI could and in prudence should have bought coal fired power, which was considerably cheaper than nuclear power. NOPSI has the burden to prove that it was prudent in not purchasing any coal fired power. If NOPSI had bought coal power, there would have been a significantly cheaper source of power availalbe [*sic*] to the ratepayers of New Orleans.

NOPSI contends on appeal that it had no opportunity to buy coal fired power. However, Malcolm Hurstell testified that NOPSI did not attempt to buy any coal fired power during the 1979-80 period although coal fired power was available for sale from the Southern Company and AP&L. Arkansas Power and Light built two coal fired plants at this time: White Bluff and Independence (ISES). Other companies within MSU bought power from these plants. NOPSI admits that MP&L and AP&L had bought ownership interests in the coal fired power of ISES. Hurstell testified that he did not attend the meeting at MSU at

the time when AP&L offered to sell power from ISES. Instead, Hurstell, the NOPSI representative, had given his proxy for that meeting to the representative from LP&L.

Thus the evidence shows that coal fired power was available for purchase during the period in question. NOPSI chose to rely entirely on high cost nuclear power and not to invest in lower cost coal fired power.

During this period in history, electric utility companies were moving away from dependence on oil and gas fired power. The oil embargo in 1974 taught the industry that it was risky to be dependent upon one source of energy. NOPSI, however, ignored industry studies urging diversification of nuclear power with coal fired power. Jack Lundberg testified concerning the kinds of studies that were done for other utilities. NOPSI could have done such studies but did not.

Expert testimony showed that regardless of the cost impact of Three Mile Island, coal fired power had become less expensive than nuclear power from Grand Gulf. Moreover, the greatly increased costs of nuclear power plant construction in the aftermath of Three Mile Island, estimates of which ranged from ten percent to an open-ended number, should have alerted NOPSI managers that action was necessary to avoid excessive economic damage. The 25% adjustment suggested by Komanoff was reasonable within the context of what was known at the time and ultimately turned out to be too conservative.

NOPSI contends that purchase of coal fired power would not have reduced its Grand Gulf costs and that off system sales of Grand Gulf power would not have resulted in savings. The evidence in the record clearly shows that if NOPSI had both sold its Grand Gulf power off system and bought coal fired power to replace it, substantial cost savings would have resulted. These savings form the basis for the calculation of the quantum of the

imprudence disallowance (see *infra*). NOPSI did not carry its burden of proving that its failure to buy coal fired power was prudent. Therefore it may not legally pass on its excessive and imprudent costs to its ratepayers.

We note that NOPSI contends that the Council did not prove that the ratepayers suffered any actual damages from its imprudence. In this contention, NOPSI is confusing tort law with public utility law. In tort law, the plaintiff must prove that he or she had incurred damages. In public utility law, on the other hand, the hearing agency determines whether the utility acted prudently, and, if it did not, the agency then enacts an order whereby the results of such imprudent action may not be passed on to the ratepayers. Thus, in public utility law, the agency decision in effect prevents the damages from occurring, by disallowing imprudently incurred costs from utility rates. Proof of damages is not an element that must be proven in a public utility rate disallowance case.[1]

d. Summary

The trial court found that the initial presumption of prudence had been rebutted and that NOPSI thus bore the burden of proving its prudence. NOPSI has failed to meet its burden of proof.

The trial court found that the Council relied on substantial evidence in its findings of fact and that its conclusions were not arbitrary and capricious, but rationally based.

This court affirms the findings and conclusions of the Council and the decision of the trial court. We find not only that substantial evidence in the record shows that NOPSI acted imprudently, but that the preponderance of the evidence would support the same conclusion.

[1]NOPSI also contends that FERC could have allocated the savings resulting from off system sales to the MSU system as a whole and thus reduced the savings of NOPSI. There is no evidence in the record to support this contention. Likewise there is not evidence to support NOPSI's contention that it would have had to sell Grand Gulf power off system at a reduced price.

3. PREEMPTION

a. Facial Preemption

NOPSI contends on appeal that the Council's rate order is preempted by federal law. Under the Supremacy Clause of the U.S. Constitution, Congress has the power to preempt state law. U.S. Const., art. VI, cl. 2; *N.W. Cent. Pipeline Corp. v. State Corp. Com'n of Kansas,* 489 U.S. 493, 109 S.Ct. 1262, 1273, 103 L.Ed.2d 509 (1989).

For state action to be preempted, Congress must have expressed a clear intent to preempt state law, *Jones v. Rath Packing Co.,* 430 U.S. 519, 525, 97 S.Ct. 1305, 51 L.Ed. 2d 604 (1977), or to occupy the field so completely as to leave no room for state law, *Rica v. Santa Fe Elevator Corp.,* 331 U.S. 218, 230, 67 S.Ct. 1146, 91 L.Ed. 1447 (1947). Otherwise state action is preempted only when it actually conflicts with federal law, *Florida Lime & Avocado Growers, Inc. v. Paul,* 373 U.S. 132, 142-43, 83 S.Ct. 1210, 10 L.Ed.2d 248 (1963), or is an obstacle to the accomplishment or execution of the purposes of Congress, *Hines v. Davidowitz,* 312 U.S. 52, 67, 61 S.Ct. 399, 85 L.Ed 581 (1941). *See N.W. Cent. Pipeline,* 109 S.Ct. at 1273.

NOPSI cities three of the above reasons to support its contention that federal law preempts the Council's rate order. First, it contends that Congress, in the Federal Power Act (FPA), intended to occupy the field. In the absence of explicit language in a statute declaring the intent to preempt, such intent may be inferred from the comprehensiveness of the legislation, and whether it leaves room for any state action in the field. *N.W. Cent. Pipeline,* 109 S.Ct. at 1273. The presumption is that the historical powers of the states have not been superceded [*sic*] by

federal legislation unless that was the "clear and manifest purpose of Congress." *Puerto Rico Dept. of Consumer Affairs v. Isla Petroleum Corp.*, 485 U.S. 495, 108 S.Ct. 1350, 1353, 99 L.Ed.2d 582 (1988), citing *Hillsborough County v. Automated Medical Laboratories, Inc.*, 471 U.S. 707, 715, 105 S.Ct. 2371, 85 L.Ed.2d 714 (1985). *See* also *California v. ARC America Corp.*, 490 U.S. 93, 109 S.Ct. 1661, 1665, 104 L.Ed.2d 86 (1989). Historically, "the regulation of utilities is one of the most important functions traditionally associated with the police power of the States." *Arkansas Electric Cooperative Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 377, 103 S.Ct. 1905, 1908, 76 L.Ed.2d 1 (1983).

The FPA and federal case law not only do not explicitly indicate intent to preempt, but, on the contrary, show that Congress intended to preserve state regulation of public utilities. The FPA limits federal regulation of utilities "to those matters not subject to regulation by the States." 16 U.S.C.A. #824(a). The Supreme Court stated that the FPA "had no purpose or effect to cut down state power. On the contrary, perhaps its primary purpose was to aid in making state regulation effective." *Panhandle Eastern Pipe Line Co. v. Public Service Com'n of Indiana*, 332 U.S. 507, 517, 68 S.Ct. 190, 195, 92 L.Ed. 128 (1947). Thus NOPSI's contention that Congress intended to occupy the field is without merit.

Second, NOPSI contends that there is a conflict between federal and state law, making dual compliance impossible. NOPSI alleges that it is unable to comply both with the FERC allocation order and with the Council's rate order. The FERC order regulates wholesale rates and the Council's order regulates retail rates. NOPSI could accept the FERC allocations and still sell Grand Gulf power off system. NOPSI is able to pay its FERC-mandated costs under the Council rate order. We find no conflict between the two orders which would hinder compliance with both.

NOPSI's third contention is that the Council's rate order frustrates the purpose of Congress in the FPA, and specifically, the

FPA's delegation of responsibility for wholesale ratemaking to FERC. As stated above, the FPA left state regulation of local ratemaking intact. Therefore we find that the Council's rate order is not an obstacle to the accomplishment of the purposes of Congress in the FPA.

NOPSI further contends that federal preemption is required by the U.S. Supreme Court decisions in *Mississippi Power & Light Co. v. Mississippi ex rel. Moore (MP&L)*, 487 U.S. 354, 108 S.Ct. 2428, 101 L.Ed.2d 322 (1988) and *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 106 S.Ct. 2349, 90 L.Ed.2d 943 (1986). The Supreme Court discussed both of these cases in its opinion in *NOPSI III* and found no conflict between its previous decisions and its holding in the instant case. 109 S.Ct. at 2509. The U.S. Fifth Circuit had previously distinguished both of these decisions from the present case. *NOPSI III*, 850 F.2d at 1075-76.

Ultimately, the question of facial preemption has already been decided by the federal courts. In *NOPSI III*, the Supreme Court stated that the question of facial preemption may be resolved upon inquiry within the "four corners of the Council's retail rate order." 109 S.Ct. at 2515. The Court found that the appropriate question is "whether [the Council] has a substantial, legitimate interest in regulating intrastate retail rates. It clearly does." *Id.* at 2516. The Court ruled that a facial preemption claim is inappropriate in this case. "Nothing in this [case] is directly or even indirectly foreclosed by the federal statute, the regulations implementing it, or the case law applying it." *Id.* at 2517.

On appeal after remand, the U.S. Fifth Circuit did an extensive review of the facial preemption claim. *NOPSI IV*, 911 F.2d 993, 999-1002. It considered that claim in the light of the filed rate doctrine and the decisions in *Nantahala* and *Mississippi Power and Light*. The Fifth Circuit held that the Council's rate order is not facially preempted. *Id.* at 1002.

Following the United States Supreme Court and the U.S. Fifth Circuit, we hold that there is no merit to NOPSI's contention of facial preemption by federal law and find that this issue is *res judicata.*

b. Pretext Claim

NOPSI contends that the Council's rate order covertly operates as a "pretext" for collaterally attacking the allocations made by FERC. Thus, NOPSI argues, Council action on rates was preempted by the orders of FERC, [which] allocated the percentage of Grand Gulf power NOPSI is required to take, as well as the wholesale rates.

Prudent management, resale options and risk reduction options were not within the scope of FERC's review when it allocated power to the various utility companies in the MSU system. FERC did not have jurisdiction to consider the proposed retail rate increase since this was not an interstate transaction filed before it for approval. 16 U.S.C. #824(e). FERC made no attempt to assert jurisdiction over the question of NOPSI's prudence in failing to act to minimize its losses. *NOPSI IV,* 911 F.2d at 1002. We find no conflict between the Council's rate order and the findings of FERC in this case.

NOPSI claims that the findings of the rate order were "merely a cover for the determination that the original Grand Gulf investment was unwise." 109 S.Ct. at 2515. The Supreme Court viewed this claim as basically identical to the sufficiency of the evidence question in the prudence inquiry. The pretext claim "hinges largely on the plausibility of the Council's finding that NOPSI should have, and could have, diversified its supply portfolio and thereby lowered its average wholesale costs." *Id.* NOPSI contends that there should be further inquiry into the Council's motivation in making the rate order. The U.S. Fifth Circuit, on appeal after remand, reviewed this contention and held that the

"pretext claim has little functional difference from the state court's sufficiency of the evidence review, and motivation is not relevant." 911 F.2d at 1004.

We find no merit to NOPSI's pretext claim both for the reasons stated above and because we have found the evidence for the rate order decision to be sufficient.

4. *COMMERCE CLAUSE*

The U.S. Constitution, Art. I, Sec. 8, Cl. 3, gives Congress the power to regulate commerce among the states. Congress must, however, manifest this intent clearly and a court cannot presume federal legislation. *New York State Dept. of Social Services v. Dublino,* 413 U.S. 405, 413, 93 S.Ct. 2507, 2513, 37 L.Ed. 688 (1973). In the absence of conflicting federal legislation, states may exercise police power over matters of legitimate local concern even though such regulations may affect interstate commerce. *City of Philadelphia v. New Jersey,* 437 U.S. 617, 623-24, 98 S.Ct. 2531, 2535, 57 L.Ed.2d 475 (1978).

The "regulation of utilities is one of the most important of the functions traditionally associated with the police power of the states." *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission,* 461 U.S. at 377, 103 S.Ct. at 1908. "Need for new power facilities, their economic feasibility, and rates and services, are areas that have been characteristically governed by the States." *Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Commission,* 461 U.S. 190, 205, 103 S.Ct. 1713, 1723, 75 L.Ed.2d 752 (1983).

NOPSI first contends that the Council's "attempt to regulate certain aspects of Grand Gulf is a prohibited regulation of matters in interstate commerce." NOPSI further claims that the Council's rate order represents an uncontrolled regulation of the production and transmission of electricity in interstate commerce.

However, in fact, the Council has only regulated retail utility rates within Orleans Parish. In so doing it is within its authority under the Louisiana Constitution and under its own Home Rule Charter. The U.S. Supreme Court has found that the "Council has not sought to regulate interstate wholesale rates." 109 S.Ct. at 2517. The authority to establish retail utility rates has not been preempted by federal legislation, as has been discussed above.

NOPSI also contends that the rate order is a form of economic protectionism, attempting to exclude high cost nuclear power from the city of New Orleans. NOPSI bases its argument on a decision of the Eighth Circuit, *Middle South Energy, Inc. v. Arkansas Public Service Commission,* 772 F.2d 404 (8th Cir. 1985). In that case, the Arkansas Public Service Commission refused to recognize the FERC allocation to AP&L and therefore denied the inclusion of any of that allocation in retail rates. This case may readily by [*sic*] distinguished from the instant case, because the Council does not challenge the FERC allocations, but considers only the imprudence and negligence of NOPSI management.

A state or municipal law "must be upheld if it 'regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental.' " *Edgar v. Mite Corp.,* 457 U.S. 624, 640, 102 S.Ct. 2629, 2639, 73 L.Ed.2d 269 (1982), citing *Pike v. Bruce Church, Inc.,* 397 U.S. 137, 142, 90 S.Ct. 844, 847, 25 L.Ed.2d 174 (1970). State interference in the production and transmission of energy, especially when it places burdens on other states, is prohibited under the Commerce Clause. *Arkansas Electric,* 461 U.S. at 377, 103 S.Ct. at 1908-09; *Middle South Energy, Inc.,* 772 F.2d at 412-17. "The critical inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State." *Healy v. Beer Institute, Inc.,* 491 U.S. 324, 109 S.Ct. 2491, 2499, 105 L.Ed.2d 275 (1989).

We find that the Council has merely been engaged in the regulation of local retail rates, a proper state function, and has not

sought to restrict the production or transmission of energy among the states. NOPSI's Commerce Clause argument has no merit.

5. *DUE PROCESS*

NOPSI contends that it has been denied due process because the Council used its legal and technical staff during both the evidentiary and the decisional phases of the hearing process. NOPSI argues that this "commingling of functions" is prohibited by law and that it deprived NOPSI of meaningful judicial review.

The Council publicly stated the procedure it would be following in its Resolution 86-43, issued on February 6, 1986. The procedure followed by the Council was in accord with this resolution and with the practice of the Louisiana Public Service Commission, which regulates rates of utilities outside of New Orleans. *See* LSA-R.S. 45:1163.3 and 1180(B).

According to the record, the first time NOPSI raised any objection to the implementation of the Council's procedure was eighteen months after the procedure was announced, in a letter dated July 31, 1987, addressed to Councilmember Taylor and written by NOPSI special counsel Alan Wolf. That letter did not object to the hearing procedure on the basis of any alleged violation of the Administrative Procedure Act or prohibited "commingling of functions" or denial of "meaningful judicial review." The only question of "fairness" raised by NOPSI concerned the determination of the credibility of witnesses.

NOPSI did not formally raise the "commingling of functions" issue or cite the Administrative Procedure Act until its second post-argument memorandum in the trial court, dated July 21, 1989. Thus NOPSI had acquiesced in the now-challenged procedures for more than three years, without raising these issues.

Since NOPSI raised no timely objection to the Council's procedure, the present due process challenge may be deemed waived.

NOPSI contends that it did not raise the issue earlier because the claim is based upon a decision of the Louisiana Supreme Court which was issued in its final form on June 29, 1989. This decision, *Allen v. Louisiana State Board of Dentistry,* 543 So.2d 908 (La. 1989), dealt with 45 counts of misconduct brought against a dentist before the Louisiana State Board of Dentistry. This was an adjudicative proceeding. In the adjudication in *Allen,* the prosecutor had drafted the findings of fact and conclusions for the committee in violation of the Louisiana Administrative Procedure Act, LSA-R.S. 49:958 and 960. For this reason, the Supreme Court found that due process had been violated. 543 So.2d at 915.

The *Allen* decision must be distinguished from the instant case because the hearing in *Allen* was adjudicative. The two sections of the Louisiana Administrative Procedure Act which were violated in *Allen* apply only to adjudicative proceedings. Furthermore, in *Allen*, the role of commingling of functions was secret, raising a question of fairness. In the instant case, the procedures were on public record. Finally, in *Allen*, the decision maker gave no reasons for its ruling. In the instant case, the Council's rate order provides 224 pages of reasons for its decision.

NOPSI claims that the *Allen* decision changed the law. We disagree that it changed the law, which remains as previously stated in the Louisiana Administrative Procedure Act. See LSA-R. S. 49:958, 960. The *Allen* decision itself based its finding upon "the letter of the Administrative Procedure Act." 543 So. 2d at 915.

> A. Unless required for the disposition of ex parte matters authorized by law, members or employees of an agency assigned to render a decision or to make findings of fact and conclusions of law in a case of *adjudication* . . . shall not

> communicate, directly or indirectly, in connection with any issue of fact or law, with any party or his representative, or with any officer, employee, or agent engaged in the performance of investigative, prosecuting, or advocating functions, except upon notice and opportunity for all parties to participate.

LSA-R.S. 49:960 (A) (emphasis added).

The law, both federal and state, is that a "separation of functions" is required in adjudicative proceedings, but not in legislative proceedings. The federal Administrative Procedure Act requires separation of functions in adjudicative proceedings, but explicitly exempts "proceedings involving the validity or application of rates, facilities, or practices of public utilities." 5 U.S.C.A. Sec. 554 (d) (B). *See Marketing Assistance Program, Inc. v. Bergland*, 562 F. 2d 1305, 1308-09 (D.C. Cir. 1977). Federal case law has established that separation of functions is not required in ratemaking proceedings on either statutory or constitutional due process grounds. *American Tel & Tel. Co. v. F.C.C.*, 449 Fd.2d 439, 545-55 (2d Cir. 1971); *Wilson & Co. v. U.S.*, 335 F.2d 788, 796-97 (7th Cir. 1964), cert. denied, 380 U.S. 950 (1965). The U.S. Supreme Court has stated that under federal and state case law, the combination of investigative and judging functions is not a denial of due process. *Withrow v. Larkin*, 421 U.S. 35, 52, 95 S.Ct. 1456, 1467, 43 L.Ed.2d 712 (1975), citing 2 K. Davis, Administrative Law Treatise, Sec. 13.02, at 175 (1958). In Louisiana, the state Administrative Procedure Act distinguishes between judicial proceedings, in which separation of functions is required (LSA-R.S. 49:958, 960), and rulemaking proceedings, in which it is not (LSA-R.S. 49:953).

The procedures implemented by the Council in its ratemaking process in the instant case were not adjudicative, but legislative. The U.S. Supreme Court found in *NOPSI III* that: "The Council's proceedings in the present case were not judicial in nature."

109 S.Ct. at 2519. Moreover, "the Council's proceedings here were plainly legislative." *Id.* at 2520. The Supreme Court further held that "ratemaking is an essentially legislative act." *Id.* at 2520, citing *Colorado Interstate Gas Co. v. Federal Power Commission*, 324 U.S. 581, 589, 65 S.Ct. 829, 833, 89 L.Ed.2d 1206 (1945).

The Council followed ordinary legislative procedures. It appointed a hearing officer to take testimony of experts, held public hearings, and conducted its own deliberations. The rate order of the Council, which is the decision of which NOPSI complains, includes a two page "Resolution" (R-88-14) which explicitly incorporates and acknowledges as the reasons for its decision the 224 page "Determinations and Order." The latter states in detail the reasons upon which the rate order decision is based. The "Determinations and Order" document is, on its face, ascribed to the City Council members, who are, in fact, the decision makers in the case.

NOPSI's argument based upon the prohibition of "commingling of functions" under the APA and *Allen* is without merit both because NOPSI waived its claim by failing to object to the challenged commingling within a reasonable amount of time after it was announced and implemented, and because state and federal law do not require a separation of functions in legislative or rulemaking proceedings. The U.S. Supreme Court has ruled that the actions of the New Orleans City Council in holding prudence hearings and promulgating its rate order were legislative proceedings. 109 S.Ct. at 2519-20. This question is *res judicata.*

NOPSI's second contention under *Allen* is that it was denied "meaningful judicial review." NOPSI finds the basis for this right in the Louisiana Constitution, Article I, Section 19. However, that section defines the "right to judicial review" in terms of a review "based upon a complete record of all evidence upon which

the judgment is based." La. Const., art. I, sec. 19. In the instant case, such a complete record is before the reviewing court. Therefore no violation of the state constitutional right to judicial review has occurred.

NOPSI also claims that the Louisiana APA entitles it to meaningful judicial review. NOPSI contends that the commingling of functions in the Council proceedings effectively denied it meaningful judicial review. NOPSI is here confusing two different stages of the proceeding. The agency, in this case the Council, first makes a decision. Then the courts provide judicial review of the agency's decision. Thus it is the state courts of Louisiana which are charged by law to provide meaningful judicial review. This is not the function of the City Council.

NOPSI cites LSA-R.S. 49:964, which applies to judicial review of adjudicative proceedings. As stated above, the proceedings in the instant case were legislative, not adjudicative. However, even if they were adjudicative, Section 964 requires only that the agency decision be reviewed by the court and that the review be confined to the record. LSA-R.S. 49:964(F). The reviewing court may affirm the agency decision or reverse it if substantial rights of the appellant have been prejudiced because the decision is unconstitutional or illegal, outside the authority of the agency, made upon unlawful procedure, affected by error of law, arbitrary and capricious or characterized by an abuse of discretion, or manifestly erroneous. LSA-R.S. 49:964(G).

This court has reviewed the entire record of the disputed prudence hearings and has made its decision on the basis of the criteria listed above. Thus, even though this section of the APA applies only to adjudicative proceedings, in essence its requirements have been implemented in this case despite the fact that it is a legislative proceeding. There is no evidence in the record which would indicate a denial of NOPSI's right to meaningful judicial review in the courts of Louisiana.

For the reasons stated above, we find that the claims raised by NOPSI on the basis of the *Allen* decision and the Louisiana Administrative Procedure Act are without merit.

THE APPEAL OF THE ALLIANCE FOR AFFORDABLE ENERGY

1. *THE QUANTUM OF IMPRUDENT COSTS*

The Alliance for Affordable Energy (Alliance) has appealed the disallowance of only part of the Grand Gulf construction costs which were found by the Council to be imprudent. In order to analyze this question, it is necessary to explain and then calculate the total amount of Grand Gulf construction costs and the total amount of the costs found to be imprudent.

The Council found that the imprudently incurred costs totalled approximately 31% of NOPSI's Grand Gulf costs. Rate Order at 12. According to Council Exhibit 38, the lifetime present amount of Grand Gulf construction costs is $10,242.9 million. This is based upon its present worth as of January 1, 1986. Middle South Utilities obligated itself for a 90% share of these costs, or $9,218.6 million. Of this amount, NOPSI was responsible for 17%, or $1,567.2 million. The Council found that 30.41% of NOPSI's costs were imprudently incurred. Thus the total amount of NOPSI's imprudently incurred costs is $476.58 million. There remain $1.091 billion in prudent Grand Gulf costs (that is, 69.6% of NOPSI's total Grand Gulf costs) which may legally be passed through to the ratepayers.

The Council chose to shield the ratepayers from only $186.2 million ($135 million, plus the $51.2 million from the settlement agreement) of the $476.58 million of imprudently incurred costs. The difference between the total imprudence and the amount disallowed by the rate order is $290.38 million.

2. *DISALLOWANCE OF IMPRUDENTLY INCURRED COSTS*

The Alliance for Affordable Energy, Citizens for Safe Energy, and Gary L. Groesch, representing consumers, contend on appeal that once costs have been found to have been imprudently incurred, then both law and public policy mandate that stockholders, not ratepayers, bear the burden of such costs. NOPSI contends that the position of Alliance is a pretext for challenging the FERC allocations. This contention is without merit and has been discussed *supra.*

The Council and NOPSI have both admitted that a utility may not shift imprudent costs to its ratepayers/consumers. What is at issue is whether a ratemaking body, once it has deemed certain costs imprudent, may employ a balancing of interests test and then allocate some of the imprudent costs to the ratepayers and some to the shareholders. This issue involves two questions: (1) whether a balancing test may be applied to imprudent costs, and (2) whether imprudent costs may ever be shifted to ratepayers.

a. The Use of a Balancing Test

The Alliance contends that the balancing test which the Council used to weigh the interests of the ratepayers against those of the utility's shareholders may be applied only to prudent investments, but not to imprudently incurred costs, which by law may not be passed on to the ratepayers.

The Council contends that the regulator has the right and obligation to the community to investigate the impact of a disallowance on the financial health of a utility. In addition, the Council concluded that it should not take action which might prevent NOPSI from making its FERC mandated payments for Grand Gulf. For these reasons, the Council decided to employ a balancing test. It balanced and weighed NOPSI's financial interests against the interests of the ratepayers/consumers of New Orleans,

and on the basis of financial caution reduced the amount of the imprudence disallowance, permitting two-thirds of the imprudent costs to be shifted to the ratepayers. The use of this procedure for imprudent costs was unprecedented in utility regulation jurisprudence.

Heretofore, such a balancing test has been used only in cases where the costs in question were deemed prudent. In the instant case, even the Council conceded and confessed that "a regulator has no general obligation to set rates so as to keep a utility solvent notwithstanding its imprudence." Rate Order at 179. A witness for NOPSI, investment banker Robert Jones, also admitted that investors cannot rely on the recovery of imprudently incurred expenses. The Council and NOPSI have been unable to cite and we have been unable to locate any legal authority that authorizes a regulator to pass through to the ratepayers any portion of the expenses found to be imprudently incurred.

Yet contrary to its own admission above, the Council decided to balance the financial interests of NOPSI against the interests of the ratepayers, basing the decision solely on its desire to preserve NOPSI's solvency.

The Council attempted to justify its position in using a balancing test as an exercise of regulatory flexibility, by citing *Duquesne Light Co. v. Barasch,* 488 U.S. 299, 109 S.Ct. 609, 620, 102 L.Ed.2d 646 (1989). *Duquesne* dealt with prudent investments which had been abandoned before completion. Pennsylvania has a statute which disallows costs which are not "used and useful," that is, which are not actually used in producing power for public consumption. Pa. Cons. Stat. Ann., Tit. 66, Sec. 1315. Costs which were not "used and useful in service to the public" cannot be passed through to consumer rates. In *Duquesne,* the costs in question were deemed prudent, but not "used and useful." On balance, since the amount of abandoned investment was not large enough to threaten the solvency of the utility, the regulator had

the flexibility to exclude these prudent, but not used or useful, investments from rates. In the instant case, however, the issue is expenses found to be imprudent because of the negligence of the utility's management. Louisiana law has no "used and useful" exclusion. Furthermore, the costs in *Duquesne* were prudent costs. The *Duquesne* decision does not justify the application of a balancing test in a case where the costs were found to be imprudent.

The Council cited the balancing test described by the Supreme Court in *Federal Power Commission v. Hope Natural Gas Co.,* 320 U.S. 591, 603, 64 S.Ct. 281, 288, 88 L.Ed. 333 (1944), which involved the balancing of investor versus consumer interests. *Hope* dealt with the question of the "fair value" to be realized on investments not found to be imprudent. *Hope* provides no guidance concerning the use of a balancing test when costs have been found to be imprudent. Consumers obviously do not have an interest in bearing the imprudently incurred expenses of a utility. *Hope* does not provide legal justification for the Council's use of a balancing test.

The U.S. Supreme Court has long held that a regulated public utility has no constitutional right to make a profit or to receive net revenues. *Hope,* 320 U.S. at 603, 64 S.Ct. at 288; *Federal Power Commission v. Natural Gas Pipeline,* 315 U.S. 575, 590, 62 S.Ct. 736, 745, 86 L.Ed. 1037 (1942). Even the financial survival of a utility company is not sufficient reason for assigning high rates to the public. *Market Street Railway Co. v. Railroad Comm'n of California,* 324 U.S. 548, 65 S.Ct. 770, 89 L. Ed. 1171 (1945).[1]

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[1]During the hearings held from October 21-24, 1986, the Attorney General of Louisiana intervened and stated that NOPSI's imprudently incurred costs should not be considered when setting retail rates and that the City should have examined Chapter 11 bankruptcy as "an available and appropriate means of distributing imprudently or illegally incurred costs" if NOPSI were unable to absorb them. In addition,

(Footnote continued on following page)

Thus there is no basis in law for the use of a balancing test in a case where costs have been found to be imprudent. This court finds no reason to change or extend the law to allow other interests to justify the shift of imprudent costs to ratepayers and the public.

b. The Disallowance of Imprudent Costs

The larger question is whether the Council has the right ever to decline to disallow any portion of the costs it had found to be imprudent. As there is no legal precedent for the use of a balancing test in regard to imprudently incurred costs, so, likewise, there is no legal basis for the failure to disallow any part of costs found to be imprudent.

In the instant case, both the Council and NOPSI have admitted that costs found to be imprudent may not be passed through to the ratepayers. In its rate order, the Council admitted that its findings were based upon "the longstanding principle that costs may be passed on to the ratepayers only to the extent that they have been prudently incurred." Rate Order at 31, citing *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U.S. 276, 43 S. Ct. 544, 67 L. Ed. 981 (1923) (Brandeis, J., concurring). In its brief on appeal, the Council reiterates the

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(Footnote continued from previous page)
Citizens for Safe Energy (SAFE), introduced testimony of Theodore Eisenberg, who was qualified as an expert in bankruptcy and financial reorganization, and who testified that reorganization through Chapter 11 bankruptcy could have significant advantages both for the consumer and for investors. No evidence was produced to show that such a reorganization would prevent implementation of the FERC allocation plan or prevent NOPSI from paying its share of Grand Gulf. The Council chose not to consider the proposed option of Chapter 11 bankruptcy as an alternative to the pass through of imprudently incurred costs. On appeal, the Alliance contends that this decision was in error. We find that the Council's decision not to consider the possibility of reorganizational bankruptcy to have been erroneous. However, the issue is moot because the Council should not have used a balancing test in the first place.

"uniform rule . . . that a utility's shareholders, not its ratepayers, must bear the costs of bad management." Council Brief at 12, n.6. Even NOPSI did not disagree with the principle that if the prudence investigation is lawful, the Council must "fully implement its findings into an appropriate order." NOPSI Brief, at 69. After finding NOPSI's actions and omissions to be negligent and imprudent, the Council took "the normal ratemaking step of making NOPSI's shareholders rather than the ratepayers bear the consequences." *NOPSI III*, 109 S. Ct. at 2517.

The expenses of a utility may be passed on to the ratepayers, absent a "showing of inefficiency or improvidence." *West Ohio Gas Co. v. Public Utilities Commission*, 294 U.S. 63, 72, 55 S. Ct. 316, 321, 79 L. Ed. 761 (1935). The key criterion for a ratemaking body to decide which costs may be passed through and which must be disallowed is whether the expenses were incurred prudently or imprudently. The purpose of a regulatory agency is "to protect power consumers against excessive prices" by assuring that costs passed-through into utility rates are just and reasonable. *Pennsylvania Water & Power Co. v. Federal Power Commission*, 343 U.S. 414, 72 S. Ct. 843, 845, & 845 n.5, 96 L. Ed. 1042 (1952). Such protection should exclude all costs which have been extravagantly or unnecessarily incurred. *Acker v. United States*, 298 U.S. 426, 430-31, 56 S. Ct. 824, 827, 80 L. Ed. 1257 (1936). The Louisiana Supreme Court has likewise stated with approbation that "ratepayers should not bear the burden of a utility's imprudence." *South Central Bell Telephone v. Louisiana Public Service Commission*, 352 So.2d 964, 972-73 (1977), *cert. denied*, 437 U.S. 911 (1978).

Since the *Hope* decision, "the Supreme Court has repeatedly emphasized that the primary purpose of federal [and state] regulation of the natural gas and electric industries has been to protect consumers from unreasonable prices charged by utilities that take advantage of their monopoly or near-monopoly status." Drobek,

From Turnpike to Nuclear Power: The Constitutional Limits on Utility Rate Regulation, 65 Boston U. L. Rev. 65, 95 (1985). In addition, the "Supreme Court's ratemaking cases demonstrate that a substantial public interest can justify a good deal of economic harm to the investor interest without violating the Constitution." *Id.* at 97.

When the New York Public Service Commission disallowed approximately $1.4 million in imprudent costs incurred in the construction of the Shoreham nuclear power plant, it wrote:

> [W]e regularly deny recovery of costs that have resulted from imprudent actions. These disallowances are a fundamental part of our responsibility to set just and reasonable rates and are necessary to protect the public from being victimized by the monopoly power of a public utility. If a competitive enterprise tried to impose on its customers costs from imprudent actions, the customers would take their business to a more efficient provider. A utility's ratepayers have no such choice. A utility's motivation to act prudently arises from the prospect that imprudent costs may be disallowed.

In Re Long Island Lighting Co., 71 P.U.R. 4th 262, 266 (N.Y. Pub. Serv. Com'n., 1985), affirmed in *Long Island Lighting Co. v. Public Service Com'n*, 134 A.D.2d 135, 523 N.Y.S.2d 615 (N.Y. A.D. 1987). The New York Supreme Court held that "[i]t would be neither just nor reasonable for a utility's customers to bear the cost of inefficient management or poor planning." 523 N.Y.S.2d at 620.

In the instant case, the Grand Gulf nuclear power plant project has been characterized by a federal court of appeal as "catastrophically uneconomical." *Mississippi Industries v. F.E.R.C.*, 808 F.2d 1525, 1528 (D.C. Cir. 1987). A public utility which has imprudently managed its own involvement in such a project should not be guaranteed the right to solvency. Dr. Jeffrey Barach of Tulane University School of Business testified that "[o]nce the

leadership of a business finds out that it cannot lose, it can no longer be held accountable for the reasonableness of its decisions." Dr. Barach suggested that the Council's decision to limit the amount of the disallowance would signal management "that grossly imprudent acts are better than slightly imprudent acts." The costs of a slightly imprudent act could be written off, since they would not threaten the company's viability. However, the costs of a grossly imprudent act, such as the management of the Grand Gulf project, would "be borne only fractionally by the stockholders because its sheer magnitude threatens the company." This could encourage the management of NOPSI or other utilities to undertake even more expensive imprudent projects in the future, since then a larger portion of the costs would be passed on to the ratepayers.

"The concept of a prudent investment in public utility law is a regulatory oversight standard that attempts to serve as a legal basis for judging whether utilities meet their public interest obligations." R. Burns, R. Poling, M. Whinihan, and K. Kelly, *The Prudent Investment Test in the 1980s*, iv (1985). This court strongly affirms the importance of the prudence standard for motivating public utilities to prudent management of their affairs and for protection of the interests of the ratepaying public against excessive and unjust utility rates.

The U.S. Supreme Court has held that a "public utility will not be permitted to include negligent or wasteful losses among its operating charges. "*West Ohio*, 294 U.S. at 68, 55 S.Ct. at 319. In even stronger language, the Supreme Court held that when charges are for public service, "regulation cannot be frustrated by a requirement that the rate be made to compensate extravagant or unnecessary costs for these or *any purposes*." *Acker v. U.S.*, 298 U.S. at 431, 56 S.Ct. at 827 (emphasis added).

Thus the law does not recognize any justification for failure to disallow all costs found to have been imprudently incurred by a

utility. The ratemaking body acted contrary to law in weighing the financial state of NOPSI and in deciding to disallow only a portion of the $476.58 million of Grand Gulf costs found to be imprudent. This decision is also contrary to public policy.

This Court finds that the reasons articulated by the Council for reducing the disallowance of the pass through to the ratepayers of the totality of costs found to be imprudently incurred were insufficient and contrary to law and public policy. Imprudently incurred costs cannot legally be passed on to the ratepayers/consumers. If the Council did illegally pass imprudent costs through, such [illegible] would be in violation of the ratepayers' constitutional [illegible] property and due process of law under the Louisiana Constitution, Art. I, Sections 2 and 4, and the U.S. Constitution, Amendments 5 and 14.

A utility does not enjoy an absolute right to solvency or profit. A public utility is a monopoly which exists in a non-competitive market. Because a utility enjoys such a great economic advantage, it owes a high duty of prudence to its consumers in decision making, operation and management. Regulators of utilities must strictly inspect and examine them since such entities are without competition in a free market. Power consumers are unable to select an alternative utility for power. Consumers possess federal and state constitutional rights to protect them against the taking of their property without due process of law. When power costs are increased and shifted to consumers, the latter must accept the increases without recourse. Therefore the pass through of imprudent costs to ratepayers/consumers is prohibited by law. The public ought not to bear the burden of utility imprudence or misconduct.

Further, the stockholders of a utility have no right to a profit as a matter of law. A utility would have no incentive to behave prudently in its transactions if it bore no risk of loss. Law and public policy in their present form encourage utilities to manage

their affairs in a prudent manner. Modification of the existing legal rules would not only sanction imprudent utility management and operation, it would also promote waste, inefficiency and misconduct at public expense. Therefore, we decline to change the law or establish a new remedy for imprudently incurred costs.

As a result of its improper use of a balancing test, the Council chose to disallow only $150 million of NOPSI's imprudently incurred costs. The Council then made a further decision to reduce the $150 million disallowance by ten percent, or $15 million, to $135 million, even though the Council admitted that its experts had found that NOPSI could sustain a disallowance of $150 million. Rate Order at 13 and 220. The Council generously decided that "as a matter of caution and conservatism," this ten percent reduction would "provide a buffer or margin . . . to allow for the uncertainty inherent in financial projections and for the possibility that circumstances could change to NOPSI's detriment." *Id.*

The reduction of the $150 million disallowance by ten percent is manifestly erroneous. It is unreasonable, arbitrary and contrary to the evidence in the record, which shows that NOPSI could withstand a disallowance of $150 million or more. The reduction of the disallowance by $15 million is reversed because it is contrary to the evidence. At the same time, the entire reduction of the total amount of imprudent costs is reversed because it is contrary to the law and public policy. The original finding of the Council that approximately 31% of NOPSI's total Grand Gulf costs were imprudently incurred is affirmed, and the rate order is amended to restore the full amount.

CONCLUSION

This Court affirms the February 4, 1988, rate order of the New Orleans City Council in its findings that NOPSI imprudently incurred approximately 31% or $476.58 million of its Grand Gulf costs. We find that the prudence investigation conducted by the

Council was legal and proper, and that the findings and conclusions of the Council were just, reasonable and based upon substantial evidence. We also find that the Council did not challenge the FERC allocation or the wholesale rates fixed by FERC, that the Council did not in any way violate federal or constitutional law, and that the procedures which it employed were legal and proper.

We affirm the rate order and the decision of the district court as to the above findings. We amend the rate order to disallow the pass through by NOPSI to the ratepayers of New Orleans of any of the imprudently incurred costs, including an additional $290.38 million not previously disallowed, or a total disallowance of $476.58 million.

Affirmed in Part, Reversed in Part, Amended in Part.

(8)

No. 90-1156

FILED
APR 11 1991
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*,
Respondents.

On Petition For Writ Of Certiorari To The United States Court of Appeals For The Fifth Circuit

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RESPONDENTS' SECOND SUPPLEMENTAL FILING

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-1156

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*,
Respondents.

RESPONDENTS' SECOND SUPPLEMENTAL FILING

On April 6, 1991, petitioner made a supplementary filing pursuant to Rule 15.7 to bring attention to the April 4, 1991 decision of the Louisiana Court of Appeals for the Fourth Circuit, which upheld the Council's rate order, except as the order sought to moderate the remedy imposed upon NOPSI, based on consideration of its economic impact. *Alliance for Affordable Energy, Inc. v. Council of the City of New Orleans*, 90-CA-0420. Petitioner's filing emphasized that the decision would result in its bearing a substantial additional disallowance for imprudence.

On April 9, 1991, respondents made a supplementary filing more fully describing the aforesaid intermediate state appellate court decision and its posture under Louisiana procedural rules.

The instant supplement is filed to call attention to the intervening April 5, 1991 decision of the Louisiana Supreme Court in *Gulf States Utilities Company v. Louisiana Public Service Commission*, 88-CA-0709, 90-CA-0445, which upholds the type of moderation approach toward a prudence disallowance followed here by the Council. It specifically holds that in a prudence proceeding a regulator may take steps "tempering the disallowance in order to maintain the utility's solvency" (Slip Op. at 46), and "could reasonably have concluded that consumer interests were better served by maintaining [the utility] in a position to provide a reliable supply of electric service than by resorting to the uncertainties of the bankruptcy court." *Id.* (an extract from the opinion is attached as an appendix hereto).

The Fourth Circuit decision referred to above will have to be conformed to this statement of Louisiana law when this and other issues are finally determined in the course of the state's rehearing and appellate processes. These events further underscore the appropriateness of the Court's declining to become involved in the matter at this stage.

Respectfully submitted,

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April 15, 1991

SUPREME COURT OF LOUISIANA

Nos. 88 CA 0709
90 CA 0445

GULF STATES UTILITIES COMPANY

Versus

LOUISIANA PUBLIC SERVICE COMMISSION

CALOGERO, Chief Justice

• • •

[EXTRACT]

Regarding the arguments of the Attorney General, it is true that public utility regulation does not insure that the business shall produce net revenues. *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). The Supreme Court decisions in *Hope* and the subsequent case of *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), have been construed to mean that there is no requirement that the end result of a rate-making body's adjudication must be the setting of rates at a level that will guarantee the continued financial integrity of the utility. See, *e.g.*, *Kansas Gas & Elec. Co. v. State Corp. Comm'n*, 720 P.2d 1063 (Kan. 1986); *Appeal of McCool*, 514 A.2d 501 (N.H. 1986); *Pennsylvania Elec. v. Pennsylvania Pub. Util.*, 502 A.2d 130 (Pa. 1985). However, it is also true that it is the Public Service Commission which is constitutionally accorded the authority to decide how the interests of ratepayers and the utility should be balanced in any given rate case. In the exercise of that authority, the Commission may, within its discretion, make a policy determination concerning whether the interests of

the ratepayers are better served by disallowing the full damages flowing from a utility's imprudence, or by tempering the disallowance in order to maintain the utility's solvency. See *Appeal of McCool*, 514 A.2d 501 (N.H. 1986).

The Attorney General does not dispute the Commission's authority to make such a policy determination. Rather, he argues that because there was no inquiry concerning the total damages resulting from Gulf States' imprudence or the effects of its insolvency, the Commission had no factual basis on which to make such a determination in this case. The record reveals, however, that employees of Kennedy & Associates did testify regarding their estimates, albeit rough ones, of the total disallowance which would result if the Cajun buybacks and accounting deferrals (the two factors which the Commission chose to disregard in calculating the imprudence disallowance) were considered. In addition, Mr. Komanoff analyzed what the expected cost of an alternative coal plant would have been, and testified extensively on the full imprudence disallowance which he would recommend concerning Gulf States' investment in River Bend. As a result of this testimony, the Commission found that the full extent of the damages resulting from the company's imprudent decision was $2 billion. Further, there was testimony before the Commission, presented by witnesses on behalf of the Attorney General, concerning the possible beneficial effects of bankruptcy reorganization of utilities in general, and of Gulf States in particular. Given the evidence in the record, we find that the Commission could reasonably have concluded that consumer interests were better served by maintaining Gulf States in a position to provide a reliable supply of electric service than by resorting to the uncertainties of the bankruptcy court.

[Slip op. at 45-46.]

• • •

AFFIRMED IN PART; REVERSED IN PART

Supreme Court, U.S.
FILED
JUL 3 1991
OFFICE OF THE CLERK

(9)

No. 90-1156

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*,
Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

JOINT APPENDIX

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PETITION FOR CERTIORARI FILED JANUARY 15, 1991
CERTIORARI GRANTED APRIL 22, 1991

TABLE OF CONTENTS

Relevant Docket Entries in the United States Court of Appeals for the Fifth Circuit 1

Relevant Docket Entries in the United States District Court for the Eastern District of Louisiana 4

Opinion of the United States Court of Appeals for the Fifth Circuit (Aug. 29, 1990, as amended on Feb. 8, 1991) ... 11

1973 MSU System Agreement 34

Resolution of the Council of the City of New Orleans, *In the Matter of Ex Parte Application of New Orleans Public Service Inc. for an Increase in Its Electric Rates, Docket No. CD-85-1 (Prudence Inquiry)* (Feb. 4, 1988) 55

Prudence Investigation: Determinations and Order Regarding the Prudence of the Management of New Orleans Public Service Inc. with Respect to Grand Gulf I, *In the Matter of Ex Parte Application of New Orleans Public Service Inc. for an Increase of Its Electric Rates, Docket No. CD 85-1* (Feb. 4, 1988) 58

Plaintiff's Statement of Uncontested Material Facts (Sept. 12, 1989) 280

Defendants' Response to "Statement of Uncontested Material Facts" (Oct. 16, 1989) 297

Excerpts from Transcript of Proceedings (Oct. 25, 1989) . 327

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

Case Number 90-3050

NEW ORLEANS PUBLIC SERVICE, INC.,

Plaintiff—Appellant,

versus

THE COUNCIL OF THE CITY OF NEW ORLEANS, ET AL.,

Defendants—Appellees.

RELEVANT DOCKET ENTRIES

1.	RECORD, EXHIBITS AND BRIEF INFORMATION	
	Transcript due—on file	
1/25/90	Record on Appeal	No. of Vols.—5
3/90	Supp. Record	No. of Vols.—1
3/12/90	Second Supp. Record	No. of Vols.—1
4/6/90	Third Supp. Record	No. of Vols.—1
1/25/90	Exhibits	1 Box
3/12/90	Exhibits	(Rm. 221) 3 Boxes
3/6/90	Records Excerpts—Appellant	
1/25/90	Brief Notice Issd.	
3/6/90	Brief for Appellant	
4/6/90	Brief for Appellee (Alliance)	
4/6/90	Brief for Appellee (Council)	
4/23/90	Reply Brief for Appellant (14 Days later)	
6/5/90	Rule 28(j) letter—Appellee (J)	
2.	MISCELLANEOUS FILINGS	
1/24/90	Dup. Notice of Appeal and Clerk's Statement of Docket Entries	

3. AGENCY REVIEW CASES [N/A]

4. EXTENSION

None—Expedited

5. CALENDAR INFORMATION—WEEK OF 6/4/90

4/27/90 Case Assigned for 6/5/90 in EB
Hearing Panel: JMW-PEH-JMD

6/5/90 Case Argued by Appellant and by Appellee

6. OPINION INFORMATION—P[UBLISHED] 14 Pages

8/29/90 Opinion Rendered
PEH—Affirmed
Signed
Issd. in P form; p. 6085

7. REHEARING INFORMATION

9/4/90 Motion for Ext.—Ext. to 9/26/90 (J)

9/26/90 Petition for Rehearing (J)
Appellant; Reg.

10/17/90 Order Denying Rehearing

8. MOTIONS

Motion to or for:

3/6/90 Supplement Record (NOPSI) (unopposed)—Granted by Clerk 3/6/90

4/6/90 Supp. record—Council (unopposed)—Granted by Clerk 4/6/90

9. OTHER DOCKET ENTRIES

3/6/90 Flg. Appellant's motion to set an early argument date.

3/8/90 Flg. appellees' ltr. dtd. 3/7/90 confirming that they will file response to above motion.

3/14/90 Flg. appellee's response to appellant's motion to set an early argument date.

3/16/90 Flg. appellant, NOPSI's reply to appellees' opposition to appellant's motion to set an early arg. date.

3/21/90 Flg. order GRANTING appellant's motion to set an early arg. date, treated as a motion to expedite the appeal. (TGG)

4/3/90 Flg. ltr. dtd. 4/2/90 from Cnsl. Moot for Council for City of N.O. advising will file brief on 4/6/90 as they were not served until 3/7/90.

4/26/90 Flg. motion of appellee, Council of City of N.O. to strike appellant's out of time reply brief. Sub PEH 4/27/90.

5/2/90 Flg. order DENYING motion of appellee, Council of City of N.O. to strike appellant's reply brief as untimely. (PEH)

5/3/90 Flg. NOPSI'S RESPONSE to motion to strike reply brief (submitted to Court at cnsl's request even though motion already ruled upon—joan)

5/3/90 Flg. ltr. dtd. 5/2/90 from NOPSI's cnsl. directing that above response be forwarded to the court even though motion to strike has been denied.

5/7/90 Flg. ltr. dtd. 5/4/90 from Council's cnsl. in response to above ltr.

9/27/90 Flg. ltr. dtd. 9/27/90 from Cnsl. Abbot enclosing corrected page 9 of panel rehearing (Faxed to panel)

10. JUDGMENT OR MANDATE INFORMATION

Ea. party to bear its own costs.

8/29/90 Flg. & Entg. Judgment

10/29/90 Record on Appeal Rtd. to Clerk (6 Vols.)

10/29/90 Exhibits Rtd. to Clerk (4 Boxes)

11. SUPREME COURT INFORMATION

4/30/91 Preparing Proceedings on Certiorari

1/25/91 Notice of Flg. of Cert. Pet. on 1/15/91

4/24/91 Order of S.C.—Granted 4/22/91
S.C. Docket #90-1156

UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF LOUISIANA

No. 88—00559

NEW ORLEANS PUBLIC SERVICE INC.,

Plaintiff.

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, LAMBERT BOISSIERE, JR., MIKE EARLY, JOSEPH I. GIARRUSSO, JOHNNY JACKSON, JR., JAMES SINGLETON, DOROTHY MAE TAYLOR, AND PEGGY WILSON.

Defendants.

RELEVANT DOCKET ENTRIES

DATE	NR.	PROCEEDINGS
2/9/88	1	Complt, 8 sms issd. [R. 1-29]
2/9/88	2	Pltf's MTN & ORDERED that Council of City of New Orleans show cause on 3/2/88 at 10:00 am why prelim injunction should not issue. (AJMc) 2/11/88 DKTD 2/12/88. [R. 47-49]
2/9/88	3	Pltf's ntc of related case 85-5273 D & 85-3398D. [R. 102-103]
2/9/88	4	ORDERED that matter is TRANSFERRED to Section "D" (2). (GA Jr) 2/9/88 dKTD 2/12/88. [R. 104]

DATE	NR.	PROCEEDINGS
2/12/88	5	M.E. 2-12-88; Phone Conf. held; HRG. on the Mtn. for Prel. Injunction set for 3/2/88 at 10:00; BY5:00 on 2/23/88, counsel for deft. to file any Mtns. to Remand Companion lit. that has been removed to this ct by NOPSI. By Noon on 2/24/88, counsel for deft. to file any Mtns. to dism complt w/ any reply Memoranda to the req. for Inj. Relief. By 2/29/88 at Noon, NOPSI to file Opo. Memo. to the Mtns. to Remand, Opo. Memo. to Mtns. to Dism and Reply Memo. concerning the Prel. Injunct. (AJM) dktd. 2-12-88 [R. 105-106]
2/24/88	6	Mtn. by defts' to Dism. [R. 107]
2/29/88	7	Pltf's Memo. in Opo. to Mtn to Dism. and for Remand. [R. 108-171]
3/1/88	8	Mtn. by defts' & ORDERED that Clinton Vince, Bernhardt Wruble, Glen Ortman and Nancy Wodka are permitted to appear as co-counsel. (AJM) 3-1-88 dktd. 3/3/88. [R. 172-182]
3/2/88	9	M.E. 3/1/88; Hrg. set for 3-2-88 is CANCELLED. Addit'l deps will be taken March 2, 3 or 4, 1988, and all deps. and any other memranda will be subm. to ct by 12:00 Noon on Saturday, March 5, 1988. The pending Mtns. will then be considered by the Ct. on documents w/out oral arguments. (AJM) dktd. 3-3-88. [R. 183]
3/8/88	10	Reply Memo. by defts' in support of their Mnt. oto [*sic*] Dism. [R. 184-185]
3/8/88	11	Pltf's Mtn. & ORDERED that same have leave to file Supple Memo. in Support of Mtn. for Prel. Injunction. (AJM) 3-9-88 dktd. 3-10-88. [R. 186-189]
3/9/88	12	Pltf's Supple Memo. in Support of Mnt. for Prel. Injunct. [R. 190-214]

DATE	NR.	PROCEEDINGS
3/10/88	13	OPINION & ORDER: that Council's Mtn. to Dism is GRANTED and Pltf's Complt be DISM. w/out prej (AJM) 3-10-88 dktd. 3-11-88. [R. 215-229]
3/10/88	14	JUDGMENT: ORDERED in favor of Defts' and agnst. Pltf. dism. pltf's complt w/out prej. and for costs (AJM) 3-10-88 dktd. 3-11-88. [R. 230]
CLOSED		
3/10/88	15	Pltf's depo of John L. Cowan on 3/2/88. [R. 231]
3/10/88	16	Pltf's depo of Edward A. Cecil on 3/3/88. [R. 232]
3/10/88	17	Pltf's depo of David L. Quivey on 3/2/88. [R. 233]
3/10/88	18	Pltf's depo of Malcolm H. McLetchie on 3/3/88. [R. 234]
3/21/88	19	Pltf's Ntc.of Appeal of judgment entered on 3-10-88. [R. 235-236]
3/22/88	xx	Notice of Appeal forwarded to all parties. (dlm)
3/21/88	20	Pltf's Mtn. for Exped. Hrg. on Mtn. for Inj. Pend. Appeal—ORDERED Exped. Hrg. held by Phone Conf. & Mtn. for Injunct. is DENIED. (AJM) 3-21-88 dktd. 3-23-88. [R. 237-239]
3/22/88	21	Pltf's Mtn. for Injunction Pending Appeal. [R. 240-255]
3/23/88	xx	Record forwarded to Court of Appeals. (dlm)
4/11/88	22	(5TH CIRCUIT ORDER) ORDERED that pltf's mtn for injunction pending appeal is DENIED; that pltf's mtn to expedite appeal is GRANTED, Clerk directed to place appeal on next available oral argument docket. (POLITZ, JOHNSON & HIGGINBOTHAM) [R. 362-363]

DATE	NR.	PROCEEDINGS
8/22/88	xx	Record returned from Ct of Appeals. (JMD)
8/22/88	23	(5th Cir) ORDERED that the judg. of the dist. ct. is AFFIRMED; FURTHER ORDERED that pltf-appellant pay to defts-appellees the costs on appeal to be taxed by Clerk of Ct. Issd. as Mandate 8-19-88. [R. 360-361]
2/14/89	xx	Record forwarded to Court of Appeals to be certified to the Supreme Court. (dlm) [R. 356]
8/22/89	24	(5th Circuit) ORDERED that case is REMANDED to District Court for further proceedings consistent w/opinion & judg of U.S. Supreme Court. (RUBIN, GARZA, & JONES) [R. 358-359]
REOPENED		
8/25/89	25	ORDERED that status conf be held on 9/13/89 at 1:30 pm to set PTC & trial dates. (AJM) dktd 8/28/89. [R. 357]
8/30/89	xx	Record returned from Court of Appeals. (dlm)
8/30/89	26	ANSWER by defts to complt for prelim & permanent injunction & declaratory relief. [R. 346-355]
9/8/89	27	Defts' Mtn to Stay; hrg. 10/4/89 at 9am bfr Judge. [R. 278-345]
9/12/89	28	Pltf's Mtn for Summary Judg. Hrg set 10-4-89 at 9:00am bfr Judge. [R. 276-277]
		[The Fifth Circuit granted NOPSI's motion to supplement the record (see p. 2 of this Joint Appendix) so as to include therein NOPSI's memorandum

DATE	NR.	PROCEEDINGS
		in support of its motion for summary judgment and related papers. These appear at R. 751-773.]
9/12/89	29	Mtn of Citizens for savfe [*sic*] Energy, Inc., Thi [*sic*] Alliance For Affordable Energy & Gary L. Groesch & ORDER granting leave to intervene as pty defts. Intervention shall serve as answer of intervenors in this action. (AJM) 9/13/89 dktd. 9/11/89. [R. 266-275]
9/14/89	30	Complt in intervention of Citizens for Safe Energy, Inc., Alliance For Affordable Energy & Gary L. Groesch & ANSWER to pltf's complt (see doc #29). [R. 261-263]
9/13/89	29a	Mtn of Beverly Zervigon & ORDER granting leave to w/draw as counsel for defts & be subst by Michael W. Tifft. (AJM) dktd 9/14/89. [R. 264-265]
9/15/89	31	M.E. 9/14/89: Stat conf held 9/13/89. ORDER that City of New Orleans submit to court the transcript & all docs relating to Prudency Hrg by 9/27/89; responses to pltf's motion for summ judg be submitted by 10/16/89 at 5 pm. Pltf's reply brief due 10/20/89 at 4pm. Court to have special hrg on pltf's motion for summ judg & City of New Orleans' mtn to stay which has been continued to 10/25/89. (AJM) dktd 9/15/89. [R. 259-260]
9/29/89	32	M.E. 9/29/89; HRG. set for 10/25/89 at 10:00 is rescheduled to 10-25-89 at 2:00 (AJM) dktd. 10/2/89. [R. 256]
10/16/89	33	Memo of Counsil [*sic*] of the City of New Orleans in opp to mtn for summ judg of pltf. [R. 488-616]
10/16/89	34	Memo of New Orleans Public Service in opp to defts' mtn to stay. [R. 463-487]

DATE	NR.	PROCEEDINGS
10/16/89	35	Memo in opp of Alliance for Affordable Energy, Citizens for safe energy & Gary L. Groesch to mtn for summ judg and in support of mtn to stay of the Council of the City of New Orleans. [R. 415-462]
10/20/89	36	Reply Memo. by defts' [*sic*] in Support of Mtn. to Stay for the Council of the City of New Orleans. [R. 404-414]
10/20/89	37	Pltf's reply memo in support of mtn for summ judg. [R. 367-403]
10/25/89	38	Mtn of defts to stay—DENIED; mtn of pltf. for summ judg—ORDERED SUBMITTED; additional briefs to be filed by 5:00 pm on 10/30/89. (AJM) dktd 10/26/89. [R. 366]
11/3/89	39	TRANSCRIPT of proceedings held on 10/25/89 w/Judge. [R. 365]
		[The Fifth Circuit granted the Council's motion to supplement the record (see p. 2 of this Joint Appendix) so as to include therein the Council's post-argument memorandum in opposition to NOPSI's motion for summary judgment. This appears at R. 723-749.]
11/17/89	40	Mtn of defts to dismiss. Hrg set 12/13/89 bfr judge. [R. 661-720]
11/22/89	41	Memo by NO Pub Serv in oppos to Council's mtn to dism[i]ss on grounds of res judicata. [R. 655-660]
12/6/89	42	Reply Memo by defts in support of mtn to dismiss on Res Judicata Grounds of the council of New Orleans. [R. 643-654]
12/8/89	43	Pltf's Mtn. & ORDERED that same have leave to file Supple Memo in Opo. to Council Mtn. to Dism. (AJM) 12/11/89 dktd. 12/12/89. [R. 640-642]

DATE	NR.	PROCEEDINGS
12/11/89	44	Pltf's Supple Memo. in Opo. to Mtn. to Dism. [R. 629-639]
1/4/90	45	ORDERED that the instant action is stayed w/out prej. Ct. will lift Stay, on a Rule to Show Cause, if NOPSI demonstrates that the City Council is purposely delaying the appellate process in state ct. (AJM) 1/3/90 dktd. 1/4/90. [R. 620-628]
1/4/90	46	ORDERED that case is closed for statistical purposes. (AJM) 1/4/90 dktd. 1/5/90. [R. 619]
CLOSED		
1/19/90	47	Pltf's Ntc. of Appeal of Ct. decision entered on 1/4/90. [R. 617-618]
1/25/90	xx	Record forward to Court of Appeals. (dlm)
3/9/90	48	M.E. 3/9/90: ORDERED that the admin. records. from the City Council's Prudency Hrg is made part of the above record. (AJM) dktd. 3/9/90. [R. 750]
3/9/90	xx	Doc #48 forwarded to Court of Appeals. (dim)
10/30/90	xx	Record returned from Ct. of Appeals (PNC)
10/30/90	49	(5th Cir) ORDERED that Judg. of the Dist. Ct. is AFFIRMED; FURTHER ORDERED that Pitf-Appellant pay to Defts-Appellees the costs on appeal to be taxed by the Clerk of Ct. Issd. as Mandate. 10/29/90. [R. 721]
4/29/91	50	Pet. for Writ of Certiorari to the 5th Cir. is GRANTED.
5/8/91	xxx	Record fwd. to the U.S. Supreme Court (PNC) [R. 774-775]

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 90-3050

NEW ORLEANS PUBLIC SERVICE, INC.,

Plaintiff-Appellant,

versus

THE COUNCIL OF THE CITY OF NEW ORLEANS, ET AL.,

Defendants-Appellees.

Appeal from the United States District Court for the Eastern District of Louisiana

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(August 29, 1990)

(Amended February 8, 1991)

Before WISDOM, HIGGINBOTHAM, and DUHÉ, Circuit Judges.

PATRICK E. HIGGINBOTHAM, Circuit Judge:

New Orleans Public Service, Inc. asks us to reverse the district court's determination that the Council's retail rate order is not "facially" preempted by federal law, specifically a wholesale rate order the Federal Energy Regulatory Commission made under the Federal Power Act. The Council's order prevented NOPSI from recovering, in its retail rate, wholesale costs FERC ordered it to incur as a result of its participation in building the Grand Gulf 1 nuclear reactor in Port Gibson, Mississippi. In the alternative, NOPSI asks us to reverse the district court's decision to stay NOPSI's remaining claims in light of pending state court proceedings. The remaining claims include an allegation that the

stated reasons underlying the Council's order were a pretext for an impermissible attack on FERC's order. We affirm the district court's order, rejecting NOPSI's "facial" preemption challenge, in part because of the reading the Supreme Court gave the Council's order on a previous appeal. We further hold that the district court did not abuse its discretion in staying decision of the remaining claims, although it did not acknowledge the relevance of the Council members' motivation of NOPSI's pretext claim in making that decision. Our reading of the Court's opinion on the previous appeal compels us to conclude that the pretext claim cannot succeed in the face of a determination that the stated reasons underlying the Council's order were sufficiently supported by the evidence; and the state trial court had already determined that they were. There was thus no substantial federal issue remaining in the case, and the district court's order was not otherwise an abuse of discretion.

I.

This case has produced several judicial opinions, including three from this court. At each juncture the case was in a different posture, with different issues. This opinion is no exception. Thus, we repeat the facts for perspective.

A.

NOPSI is a producer, wholesaler, and retailer of electricity, providing its retail services to the city of New Orleans. Along with Arkansas Power and Light, Mississippi Power and Light, and Louisiana Power and Light, it is a wholly owned operating subsidiary of Middle South Utilities, Inc.[1] MSU operates an integrated "power pool" in which NOPSI and the three other power companies transmit the electricity they produce to a central dispatch center, and each draws back the power it needs to meet customer demand.

[1]Since this case began, Middle South Utilities has changed its name to Entergy Corporation. The parties refer to it by the old name in the briefs, and, for convenience, we do so as well.

Through the 1950's and into the 1960's, most of the MSU system's generating plants were fueled with oil or gas. In the late 1960's, MSU sought to meet projected increases in demand by adding coal-fired and nuclear energy powered generating plants. Originally, MSU planned for each of the power companies to construct one or more nuclear facilities. Mississippi Power and Light was charged with constructing two plants at Port Gibson, Mississippi, to be known as Grand Gulf 1 and 2. The Grand Gulf project quickly proved too burdensome for one company, however. MSU created another subsidiary, separate from the power companies, known as Middle South Energy, Inc. to finance, own, and operate the Grand Gulf plants.[2] In 1974, MSE in turn contracted with the power companies to finance the project. The companies agreed to pay for the construction of the plants in exchange for the right to their output. The estimated construction cost at that time was $1.2 billion.

As the project progressed, consumer demand for electric power proved to be much lower than MSU and the power companies had expected. At the same time, regulatory delays, enhanced construction requirements resulting from the Three Mile Island accident, and high inflation led to spiraling costs on the Grand Gulf project. As a result, MSE suspended construction of Grand Gulf 2, although it continued to build Grand Gulf 1. The cost of completing Grand Gulf 1 alone eventually exceeded $3 billion.

The power companies considered various methods to allocate the cost of Grand Gulf in light of these developments. In 1982, MSU filed a Unit Power Sales Agreement with the Federal Energy Regulatory Commission, which set out the shares of Grand Gulf 1 output each company was required to purchase in order to pay the construction costs. Arkansas Power and Light, which had finished it own nuclear plants, was not obligated to purchase

[2]Middle South Energy is now known as Systems Energy Resources, Inc. Again, the parties refer to it by the old name in the briefs and we do so as well.

any Grand Gulf power. Louisiana Power and Light, which had not finished its plant, was obligated to purchase 38.57%. Mississippi Power and Light was obligated to purchase 31.63%, and NOPSI 29.8%. MSU also filed a new System Agreement with FERC, which set forth the terms and conditions for coordinated operations and wholesale transactions among the four companies, but did not deal with the Grand Gulf costs.

FERC assigned the agreements to two separate Administrative Law Judges for the statutorily required task of determining whether they were just and reasonable. Both judges held that the failure to distribute the Grand Gulf costs among all the members rendered the agreements unduly discriminatory; ALJ Head further held that these costs should be allocated in proportion to each company's relative system demand. *Middle South Services, Inc.,* 30 F.E.R.C. ¶ 63,030, pp. 65,170–65,173 (1985) (System Agreement); *Middle South Energy, Inc.,* 26 F.E.R.C. ¶ 63,044, pp. 65,105–65,108 (1984) (Unit Power Sales Agreement) (ALJ Head). FERC consolidated the proceedings for review, and determined that an adjustment of the shares allocated in the Unit Power Sales Agreement was all that was necessary to render both agreements just and reasonable. FERC reduced NOPSI's share from 29.8% to 17%. The decrease did not satisfy the New Orleans City Council, however, which had argued for a 9% share for NOPSI.[3] The D.C. Circuit ordered FERC to reconsider the allocations. *Mississippi Industries v. FERC,* 808 F.2d 1525, modified on rehearing 822 F.2d 1104 (D.C. Cir.), *cert. denied,* 484 U.S. 985, 108 S.Ct. 500, 98 L.Ed.2d 499 (1987). FERC did so, and reaffirmed them; the D.C. Circuit affirmed that decision. *City of New Orleans v. FERC,* 875 F.2d 903 (D.C. Cir. 1989), *cert. denied sub nom. Mississippi v. FERC,* ___ U.S. ___, 110 S.Ct. 1805, 108 L.E.2d 936 (1990).

[3]FERC found that Grand Gulf 1 had been planned, constructed, and completed to meet the needs of the MSU System "as a whole." *Mississippi Power and Light,* 108 S.Ct. at 2434; 31 FERC ¶ 61,305, pp. 61,651-

(Footnote continued on following page)

Although its order did not expressly discuss the prudence of the project, FERC implicitly accepted the uncontroverted testimony of MSU executives, who explained why they believed the decision to construct and complete Grand Gulf 1 was sound. It also approved one of the ALJ's findings to that effect. *See Mississippi Power and Light v. Mississippi ex rel. Moore,* 487 U.S. 354, 362, 108 S.Ct. 2428, 2434, 101 L.Ed.2d 322 (1988).

B.

The Council is the local ratemaking body with final authority over NOPSI's retail rates. *See* 16 U.S.C. § 824(b); La.Rev.Stat. Ann. §§ 33:4405, 33:4495 (West 1988); *see also* the New Orleans Home Rule Charter § 4-1604. NOPSI applied to the Council for a retail rate increase to cover the increase in its wholesale rates resulting from the FERC allocation. The increase NOPSI sought would have resulted in an immediate 60% increase in retail rates. The Council denied an immediate rate adjustment, explaining that a public hearing was necessary to determine the "legality" and prudence of NOPSI's decision to enter the Grand Gulf contracts.

NOPSI responded by filing an action in the district court, requesting injunctive and declaratory relief, on the theory that FERC's order required the Council to allow NOPSI to pass all of the allocated costs to its retail customers. The district court dismissed the case, holding that under the Johnson Act, 28

(Footnote continued from previous page)

57 (1985). FERC further found that this was part of a "reasonable" system plan to diversify power sources, so it established rates that would allow MSE to recoup 100% of the Grand Gulf costs from the power companies. FERC then found that the four companies should take shares of the Systems's total nuclear power in proportion to their relative demand for all energy generated by the system. *Mississippi Power and Light,* 108 S.Ct. at 2435. As the Council points out, NOPSI's demand is 9% of the total system demand. Thus, FERC required it to bear 9% of the System's total nuclear power costs. Since NOPSI had no nuclear plant of its own, it had to bear 17% of the Grand Gulf costs in order to bear 9% of the total nuclear power costs.

U.S.C. § 1342, it lacked jurisdiction to proceed, and noted that if it had had jurisdiction, it would have abstained pursuant to *Burford v. Sun Oil Co.*, 319 U.S. 315, 63 S.Ct. 1098, 87 L.Ed. 1424 (1943). We reversed, but then affirmed on panel reconsideration because we decided abstention was proper under both *Burford* and *Younger v. Harris*, 401 U.S. 37, 91 S.Ct. 746, 27 L.Ed.2d 669 (1971). *NOPSI v. The City of New Orleans*, 782 F.2d 1236, *modified on panel rehearing*, 798 F.2d 858 (5th Cir. 1986) (*NOPSI I*).

On October 10, 1985, while *NOPSI I* was pending before us, the Council began its investigation. In a resolution, the Council said it would examine all aspects of NOPSI's participation in the Grand Gulf projects, including Grand Gulf's impact on other power supply opportunities, and NOPSI's efforts to minimize its total cost exposure for the Grand Gulf project. The resolution specifically provided that, in determining the appropriate retail rate increase, the Council would not seek to invalidate any of the agreements surrounding Grand Gulf 1 or to order NOPSI to pay MSE a wholesale rate other than that approved by FERC.

In November 1985, with *NOPSI I* still pending before us, NOPSI filed *NOPSI II* in the district court, seeking to enjoin the Council from preventing the pass-through. The district court dismissed on ripeness grounds, and in the alternative abstained. We affirmed on the ripeness issue. *NOPSI v. The Council of the City of New Orleans*, 833 F.2d 583 (5th Cir. 1987).

The Council completed its investigation on February 4, 1988, and entered a final order disallowing some of the requested increase. The order prevented NOPSI from passing through $135 million of the Grand Gulf costs. This meant that, instead of passing through the full 17% FERC required it to bear, NOPSI could pass through only 14%.

NOPSI then filed this action (*NOPSI III*) in the district court, and a parallel state action challenging the order. In the district

court, NOPSI argued the Council's order was preempted under *Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953, 106 S.Ct. 2349, 90 L.Ed.2d 943 (1986). The district court abstained under *Burford* and we affirmed, holding abstention proper under both *Burford* and *Younger*. The Supreme Court granted certiorari and reversed, holding abstention improper on either ground. *NOPSI v. The Council of the City of New Orleans*, ___ U.S. ___, 109 S.Ct. 2506, 105 L.Ed.2d 298 (1989).

On remand, NOPSI again argued that the Council's order was preempted, because on its face it impermissibly contradicted the FERC order; or alternatively, that the Council's reasons for denying a pass-through were a pretext to attack the FERC allocation. The district court held that the Council's order was not "facially" preempted, and stayed the rest of the case because the Louisiana trial court had already issued a judgment in the Council's favor in the parallel state proceedings. The state trial court held that the Council's order was supported by substantial evidence. The matter is now pending in the state court of appeals. The district court rested its decision to stay on *Colorado River Water Conservation District v. United States*, 424 U.S. 800, 96 S.Ct. 1236, 47 L.Ed.2d 483 (1976), and *Moses H. Cone Memorial Hospital v. Mercury Construction Corporation*, 460 U.S. 1, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983). The district court did not consider the relevance of the Council members' motivation to NOPSI's pretext claim in any portion of its opinion. NOPSI brought this appeal.

II.

We first consider whether the district court properly determined that the Council's order was not "facially" preempted. The preemption doctrine is not without its difficulties. At least as a point of departure it is fair to observe that federal law may preempt state law in three ways. First, Congress may expressly define the extent to which it intends to preempt state law. Second, Con-

gress may only signal intent to occupy an area. Third, state laws that conflict with federal laws are preempted, even if Congress has not expressly preempted them or otherwise signaled its intent to occupy the area. *Michigan Canners and Freezers Association v. Agricultural Marketing and Bargaining Board,* 467 U.S. 461, 104 S.Ct. 2518, 81 L.Ed.2d 399 (1984); *Burlington Northern R. Co. v. Public Utilities Commission of Texas,* 812 F.2d 231 (5th Cir. 1987). "Facially" preempted state laws, as the parties use the term, are those which the court can tell are preempted in one of these three ways simply by looking at the federal law, the challenged state law, and the cases applying them.

The Council argues that the Supreme Court foreclosed this claim in *NOPSI III.* As the Council concedes, the Court did not do so explicitly. Indeed, the Court reversed our holding on *Burford* abstention because the facial preemption challenge, limited as it was to the "four corners of the Council's retail rate order," would not unduly intrude into state processes or undermine the state's ability to maintain uniformity in retail rate regulation. 109 S.Ct. at 2515. Far from foreclosing the claim, the Court reversed our decision because we did not allow the district court to consider it. The Court's ensuing discussion of *Younger* abstention, however, generates some confusion. NOPSI argued that, even if *Younger* should apply to state retail rate proceedings, abstention in this case was inappropriate because a stay would cause NOPSI irreparable harm. Irreparable harm sufficient to preclude a stay occurs when the state law sought to be enforced is flagrantly and patently violative of express constitutional provisions. NOPSI argued that the same rule should apply if the state law similarly violated federal statutes and regulatory orders, and that the Council's order was such a state law. The Court responded:

> [W]e do not have to decide the matter here, since the proceeding and order at issue do not meet that description. The Council has not sought directly to regulate interstate wholesale rates; nor has it questioned the validity of the FERC-prescribed allocation of power within the Grand Gulf system, or the FERC-prescribed wholesale rates; nor has it reexamined the prudence of NOPSI's agreement to participate in Grand Gulf 1 in the first place. Rather, the council maintains that it has examined the prudence of NOPSI's failure, after the risk of nuclear power became apparent, to diversify its supply portfolio, and that finding that failure negligent, it has taken the normal ratemaking steps of making NOPSI's shareholders rather than the ratepayers bear the consequences. Nothing in this is directly or even indirectly foreclosed by the federal statute, the regulations implementing it, or the case law applying it. There may well be reason to doubt the Council's necessary factual finding that NOPSI would have saved money had it diversified. But we cannot conclusively say it is wrong without further factual inquiry —and what requires further factual inquiry can hardly be deemed "flagrantly" unlawful for purposes of a threshold abstention determination.

109 S.Ct. at 2517. We are of course bound by the Court's characterization of the order. It is plain, however, that the Court held only that the order was not "flagrantly" unlawful for *Younger* abstention purposes; it did not hold the facial preemption claim was foreclosed. We therefore are required to consider that claim on the merits. In so doing, we must, and we will, look to the Court's characterization for such guidance as it provides.

A.

NOPSI's facial preemption claim, as well as its pretext claim, is grounded in an aspect of the filed rate doctrine, which the Court established in *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.,* 341 U.S. 246, 71 S.Ct. 692, 95 L.Ed. 912 (1951), in dismissing a power company's challenge to the reasonableness of wholesale rates it had paid in the past. The Federal Power Commission, acting pursuant to its authority under the Federal Power Act, had determined that the challenged rates were reasonable, and the Court held that the FPC's determination settled the matter. The Court said that federal courts had no

power to set a rate other than that determined by the FPC, except upon direct review of the FPC's order, and the case was not in that posture. 341 U.S. at 251–252, 71 S.Ct. at 695–696.

The Court has since held that this aspect of the filed rate doctrine applies to state courts as well, not as a rule of administrative law, as in the federal context, but rather as a means of enforcing the Supremacy Clause. *See, e.g., Arkansas Louisiana Gas Co. v. Hall,* 453 U.S. 571, 101 S.Ct. 2925, 69 L.Ed.2d 856 (1981) (state court could not allow utility to charge a wholesale rate not approved by the FPC because the state court thought the FPC would have approved the rate as reasonable; the determination of reasonableness belonged solely to the FPC).

Several state courts have held that a state utility commission setting retail rates must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price. *See, e.g., Narragansett Electric Co. v. Burke,* 119 R.I. 559, 381 A.2d 1358 (1977); *Public Service Co. of Colorado v. Public Utilities Commission,* 644 P.2d 933 (Colo.1982); *United Gas Corp. v. Mississippi Public Service Commission,* 240 Miss. 405, 127 So.2d 404 (1961). These courts viewed their decisions as applications of the filed rate doctrine. The Court has approved these cases, characterizing the decisions as "properly driven by the need to enforce the exclusive jurisdiction vested by Congress in FERC over the regulation of interstate wholesale utility rates." *Nantahala Power & Light Co. v. Thornburg,* 476 U.S. at 966, 106 S.Ct. at 2356. It is plain, then, that if the purpose or effect of the Council's order is to redetermine NOPSI's share of Grand Gulf, even if only for the purpose of setting retail rates, it is preempted by FERC's order. *Nantahala* and *Mississippi Power and Light Co. v. Mississippi ex rel. Moore,* 487 U.S. 354, 108 S.Ct. 2428, 101 L.Ed.2d 322 (1988) guide our analysis.

In *Nantahala,* Nantahala Power and Light Co. and Tapoco, wholly owned subsidiaries of Alcoa, owned hydroelectric plants,

which they allowed the TVA to operate. In exchange, the TVA provided them jointly with a fixed supply of low-cost power. Nantahala also bought high-cost power from the TVA's power grid. An agreement between Nantahala and Tapoco gave Nantahala 20% of the low-cost power, and Nantahala calculated its wholesale and retail rates on that basis. FERC reviewed this agreement in a wholesale ratemaking proceeding, and determined that the agreement was unfair and that Nantahala was entitled to 22.5% of the low cost power. FERC ordered Nantahala to use that figure in calculating its wholesale rates. When Nantahala later applied to the North Carolina Utilities Commission for a retail rate increase, the NCUC essentially determined that the agreement was more unfair to Nantahala than FERC said it was, and that Nantahala was entitled to 24.5% of the low cost power. It required Nantahala to calculate its retail rates on that basis. The Court, citing the state court cases noted above, held the NCUC's order preempted by FERC's order, because "a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable. A State must rather give effect to Congress' desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the States do not interfere with this authority." 476 U.S. at 966, 106 S.Ct. at 2356.

The Court noted that, in *Narragansett* and *Public Service Co. of Colorado,* the state courts held that an increase in FERC-ordered wholesale rates need not always lead to a corresponding increase in retail rates. Retail rates might increase less sharply than wholesale rates, or even go down, if the utility's costs *other than* those attributable to the FERC-approved wholesale rates decrease. *Narragansett,* 381 A.2d at 1363; *Public Service Co.,* 644 P.2d at 941. The Court in *Nantahala* called this qualification "perfectly sensible," but said that it did not apply there, because the NCUC did not rest its decision on that basis, but on its disapproval of the FERC-imposed rate. 476 U.S. at 968, 106 S.Ct. at 2357.

The Court also noted that, in certain circumstances, a utility's purchase of a particular quantity of high cost power at FERC-approved rates might be unreasonable, if lower cost power were available from another source. *Id.* at 972, 106 S.Ct. at 2359. Some courts have denied pass-throughs for exactly that reason. *See Pike County Light & Power Co. v. Pennsylvania Public Utility Commission,* 77 Pa.Commw. 268, 465 A.2d 735 (1983); *Kansas-Nebraska Natural Gas Co. v. State Corporation Commission,* 4 Kan.App.2d 674, 610 P.2d 121 (1980); *Kentucky-West Virginia Gas Co. v. Pennsylvania Public Utilities Commission,* 837 F.2d 600 (3d Cir.1988). The Court determined, however, that this line of cases had no application where FERC has not only determined the rate the utility must pay for the power, but also the amount of the power the utility must purchase. In that case, there is no lower cost power available that can lessen the amount of power the utility must buy at FERC rates. 476 U.S. at 972–973, 106 S.Ct. at 2359–2360.

Mississippi Power and Light involved the same FERC allocation that is at issue here. The UPSA assigned MP & L a 31.63% share of Grand Gulf 1's costs; FERC changed that to 33%. The Mississippi Public Service Commission originally refused to allow MP & L to pass through any of these costs, but then reversed itself and allowed MP & L to pass all of them through. It did so because it concluded that MP & L would otherwise become insolvent. The Mississippi Supreme Court reversed that order, holding that the Public Service Commission had no authority under state law to allow the pass-through without conducting a prudence review, and that such a review was not preempted by federal law. The court remanded the case to the Public Service Commission to "determine whether MP & L, [MSE], and MSU acted reasonably when they constructed Grand Gulf 1, in light of the change in demand for electric power in this state and the sudden escalation of costs." *Mississippi ex rel. Pittman v. Mississippi Public Service Commission,* 506 So.2d 978, 987 (Miss. 1987).

The Court reversed, holding that "our decision in *Nantahala* rests on a foundation that is broad enough to support the order entered by FERC in this case and to require the MPSC to treat MP & L's FERC-mandated payments for Grand Gulf costs as reasonably incurred operating expenses for the purpose of setting MP & L's retail rates." 108 S.Ct. at 2438. The Court said that *Nantahala* rested on three "fundamental principles concerning the preemptive impact of federal jurisdiction over wholesale rates on state regulation": (1) that FERC has exclusive authority to determine the reasonableness of wholesale rates; (2) that FERC's exclusive jurisdiction applies not only to rates, but also to power allocations that affect wholesale rates; and (3) that states may not bar regulated utilities from passing through to retail consumers FERC-mandated wholesale rates. 108 S.Ct. at 2439. Those principles prevented the NCUC's action in *Nantahala,* and the Court held they prevented the MPSC from conducting the prudence review ordered by the Mississippi Supreme Court. *Id.* The Court held that the *Pike County* line of cases noted above had no application, just as it had none in *Nantahala,* because FERC had determined the amount of Grand Gulf power MP & L had to buy. *Id.* 108 S.Ct. at 2440. The Court also rejected an argument that FERC did not have jurisdiction to determine the reasonableness of MP & L's decision to participate in Grand Gulf. *Id.* 108 S.Ct. at 2440-2441.[4]

In sum, then, there were several things the Council was not entitled to do in the prudence inquiry. It could not base any disallowance on NOPSI's purported imprudence in deciding to participate in Grand Gulf in the first place. That is the holding of *Mississippi Power and Light.* The Council could not, of course, challenge the FERC price as inappropriate. That is the point of

[4]The Court's reasons for rejecting this argument were a bit murky. It stated that the reason FERC did not consider its jurisdiction was because the parties did not raise it, not because jurisdiction was lacking. Justice Scalia, concurring in the judgment, and Justice Brennan, dissenting, wrote separately to discuss the issue more thoroughly.

the entire line of filed rate doctrine cases. The Council also could not penalize NOPSI for buying an unreasonably high amount of Grand Gulf power, because FERC allocated the power NOPSI had to buy. NOPSI had no legal right to take any less. *Nantahala* established that the *Pike Co.* line of cases did not apply to facts like ours; *Mississippi Power and Light* established specifically that they do not apply to our facts. We therefore must determine exactly what the Council did, and whether, in light of the cases, it was entitled to do it.

B.

We have noted that the Supreme Court has already characterized the Council's order as follows:

> The Council has not sought directly to regulate interstate wholesale rates; nor has it questioned the validity of the FERC-prescribed allocation of power within the Grand Gulf system, or the FERC-prescribed wholesale rates; nor has it reexamined the prudence of NOPSI's agreement to participate in Grand Gulf 1 in the first place. Rather, the Council maintains that it has examined the prudence of NOPSI's failure, after the risk of nuclear power became apparent, to diversify its supply portfolio, and that finding that failure negligent, it has taken the normal ratemaking step of making NOPSI's shareholders rather than the ratepayers bear the consequences.

NOPSI III, 109 S.Ct. at 2517. Even were we convinced otherwise, we are bound by the Court's characterization of the order. We agree with the Court's characterization in any event. All that is left, then, is to determine whether the foregoing preemption cases permit the Council to make this order.

C.

Nantahala and *Mississippi Power and Light* reaffirmed the well-established principle that if FERC has jurisdiction over a subject, states cannot have jurisdiction over it. *Mississippi Power and Light* established that FERC had jurisdiction to determine whether the various utilities acted prudently in deciding to participate in the

Grand Gulf venture, and that the states were therefore precluded from conducting prudence inquiries on that subject. The order before us presents a variation of that question. We must decide whether FERC has jurisdiction to determine whether NOPSI acted prudently once the Grand Gulf project was underway. To do so, we must determine whether the Federal Power Act grants FERC this jurisdiction.

The first step in making this determination is to decide whether FERC has asserted this jurisdiction. We defer to FERC's construction of the act if it does not violate the act's plain meaning and is a reasonable interpretation of silence or ambiguity. *See Mississippi Power and Light,* 108 S.Ct. at 2443 (Scalia, J., concurring in the judgment) (citing *K Mart Corp. v. Cartier, Inc.,* 486 U.S. 281, 108 S.Ct. 1811, 100 L.Ed.2d 313 (1988); *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.* 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d (1984)). In *Mississippi Power and Light,* Justice Scalia, concurring in the judgment, and Justice Brennan, dissenting, debated whether this presumption applies to FERC's assertions of jurisdiction under the act. The majority's position on this point is not clear. It concluded that FERC did have jurisdiction over that particular prudence question. We need not enter this thicket here, however, for it is plain that FERC did not assert jurisdiction to determine NOPSI's prudence in not acting to minimize its losses.[5]

[5]NOPSI argues vigorously that the Council's order essentially relitigates several matters FERC had already decided. Appellant's brief at 43–48. We have already rejected this argument, relying on *NOPSI III.* See part II.B of this opinion. If the Council's order did this, the Court in *NOPSI III* would not have been able to conclude that nothing in the order was directly or indirectly foreclosed by the FERC order. In any event, the opposite conclusion still would not compel us to hold FERC asserted jurisdiction to decide NOPSI's prudence in not acting to minimize its losses. We would not only be compelled to conclude that some of the issues that were relevant to FERC's wholesale rate proceeding were also relevant to the Council's proceeding. Of course, in that case, the Council would have been bound by FERC's resolution of those issues.

We therefore must determine only whether this is a matter that Congress has nevertheless committed to FERC's exclusive jurisdiction. In doing so, we must presume that state law is not preempted, as this is an area traditionally regulated by the states under their historic police powers. Courts must assume that these state powers were not to be superseded by the Act in the absence of clear and manifest Congressional purpose. *California v. ARC America Corp.*, 490 U.S. 93, 109 S.Ct. 1661, 104 L.Ed.2d 86 (1989); *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 67 S.Ct. 1146, 91 L.Ed. 1447 (1947). We are pointed to nothing to suggest that Congress has done so.[6] Indeed, finding such jurisdiction would work the result Justice Brennan feared in *Mississippi Power and Light*, that is, to "divest states of authority to determine the prudence of costs incurred by retail utilities whenever those utilities belong to an interstate pool." 108 S.Ct. at 2449 (Brennan, J., dissenting). We would require a firmer statement of intent to preempt before finding such intrusive federal jurisdiction to exist.

Further, we are convinced that the Court in *NOPSI III* did not believe the Council could not regulate NOPSI's activities in this regard. It said that nothing in the Council's order was directly or even indirectly foreclosed by prior preemption decisions. *NOPSI III*, 109 S.Ct. at 2517. Indeed, this seems analogous to the exception the Court called "perfectly sensible" in *Nantahala*, 476 U.S. at 968, 106 S.Ct. at 2357; *see Narragansett*, 381 A.2d at 1363; *Public Service Co.*, 644 P.2d at 941. If states may deny pass throughs because costs have gone down in other areas, it seems logical that they should be able to deny them because costs would have gone down if the utility had not been imprudent. We therefore hold the order is not facially preempted.

[6]Congress of course need not expressly grant FERC the power to preempt a particular state action. Rather, when state law is alleged to be preempted by federal regulation, the court must determine whether the agency action is preemptive (making the same inquiry as for a statute); the agency's choice to act preemptively will be upheld whenever

(Footnote continued on following page)

III.

As we have noted, NOPSI has not rested its preemption argument solely on the Council order's facial invalidity. NOPSI also argues that, whatever the order's facial validity, the reasons given for denying the pass through were pretexts for the Council members' true, but impermissible, objective of attacking both the FERC allocation and NOPSI's imprudence in participating in Grand Gulf in the first place. We are unable to locate an express reference to this aspect of NOPSI's argument in the district court's opinion.[7]

In its brief and at oral argument, the Council urged that NOPSI never raised this pretext claim in its complaint. Whether we would reach the same conclusion on a fresh reading of the complaint is not relevant, however, because the Supreme Court has already held that NOPSI did raise this claim in its complaint.

(Footnote continued from previous page)
the action "represents a reasonable accommodation of . . . policies that were committed to the agency's care by the statute." *City of New York v. F.C.C.*, 486 U.S. 57, 63, 108 S.Ct. 1637, 1642, 100 L.Ed.2d 48 (1988). Nevertheless, the grant of regulatory authority can itself be preemptive. *See Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 108 S.Ct. 1145, 99 L.Ed.2d 316 (1988).

[7]As we will explain, the district court premised its decision to stay in large part upon its conclusion that there were no substantial federal issues remaining in the case, once it had resolved the facial preemption challenge. The district court said that the disposition of the facial challenge "leaves only the question of whether the Council's finding is supported by the evidence." At 997. At oral argument, the parties and the panel proceeded on the assumption that the district court ignored the pretext claim. On further reflection and examination of the opinion, we cannot conclusively say that is so. It is equally plausible to read the district court's language to mean that the court thought the pretext claim involved only an analysis of the sufficiency of the evidence, a conclusion with which we agree. We can only conclusively say that the district court did not expressly refute the argument that the pretext claim must involve an evaluation of the Council's motivation in making the rate order.

NOPSI III, 109 S.Ct. at 2515 ("It is true that in its initial complaint, NOPSI asserted, as an alternative to its facial preemption challenge, that the rate order's nominal emphasis on NOPSI's failure in 1979–80 to diversify its power supply by selling off a portion of its Grand Gulf allocation was merely a cover for the determination that the original Grand Gulf investment was unwise").

The Council further argued that the district court's decision to stay was justifiable under *Colorado River* and *Moses H. Cone Memorial Hospital,* despite the failure to consider expressly the relevance of motivation to the pretext claim. We review the decision to stay only for an abuse of discretion. *Moses H. Cone Memorial Hospital,* 460 U.S. at 19, 103 S.Ct. at 938; *Brown v. Link Belt Division of FMC Corp.,* 666 F.2d 110 (5th Cir. 1982). Under *Colorado River* and *Moses H. Cone Memorial Hospital,* the district court was required to consider whether the case presented exceptional circumstances, in which considerations of wise judicial administration—in particular the need to conserve judicial resources and promote comprehensive disposition of litigation—counselled against exercising jurisdiction. *Colorado River,* 424 U.S. at 817, 96 S.Ct. at 1246. Several factors guide this decision, none of which is necessarily determinative. *Id.* The court was required to consider the convenience of the federal forum, the desirability of avoiding piecemeal litigation, the order in which the federal and state forums obtained jurisdiction and the progress of the litigation in each, whether there existed a *res* over which one forum or both had asserted jurisdiction, which forum's law provided the rule of decision in the case, and the adequacy of the state court proceedings to protect NOPSI's rights. *Colorado River,* 424 U.S. at 819–820, 96 S.Ct. at 1247–1248; *Moses H. Cone Memorial Hospital,* 460 U.S. at 24–27, 103 S.Ct. at 941–943. The court was not to apply these factors as a mechanical checklist, but rather to balance carefully the factors important in the particular setting of the case. It was also to weight the balance

heavily in favor of exercising jurisdiction. *Moses H. Cone Memorial Hospital,* 460 U.S. at 16, 103 S.Ct. at 937.

The Council maintained that, as long as there was sufficient evidence to support the Council's stated reasons for denying the pass through, the pretext claim must fail, that there was no difference between the pretext claim and the state law challenges to the order's validity. Since the state trail court had already decided the state law challenges, and thereby already passed, albeit indirectly, on the pretext claim, the Council contended the district court properly concluded that, while federal law technically provided the rule of decision, there were no substantial federal issues remaining in the case, so the court was not compelled to exercise its jurisdiction on that basis. The Council further argued that the district court's order was not otherwise an abuse of discretion.

A.

In *NOPSI III,* the Court described the pretext claim as follows:

> Unlike the facial challenge, [the pretext] claim cannot be resolved on the face of the rate order, because it hinges largely on the plausibility of the Council's finding that NOPSI should have, and could have, diversified its supply portfolio and thereby lowered its average wholesale costs. See n. 2, supra. Analysis of this pretext claim requires an inquiry into industry practice, wholesale rates, and power availability during the relevant time period, an endeavor that demands some level of industry-specific expertise.

109 S.Ct. at 2515. The reference in this language to the earlier footnote provides further guidance. In that footnote, the Court quoted from the prior district court opinion, in which the district court expressed doubts as to the validity of the Council's stated reasons for denying the pass through:

> Adverting to the merits, the District Court commented: "[T]he Council faults NOPSI not for buying a 'pig in a poke'

but for failing to find a sucker to buy it when the faux pas became apparent."[11]

[11]P.T. Barnum once said of suckers: 'There's one born every minute.' This court, however, is not ready to assume there are many, if any, such suckers purchasing electricity in the wholesale market today. Indeed, this court is somewhat mystified by the Council's logic in arriving at the $135 million disallowance in the Rate Order. In the Rate Order, the Council simply concluded that since [NOPSI's President] said so, savings were actually possible. Then, the Council seemingly pulled from thin air a figure of 8% for the prudence disallowance. However, the Council, and in this case, everyone else knows that the 8% figure was not pulled from thin air but represents the difference between FERC's 17% allocation and what NOPSI consistently claims as its relative share of the [Middle South] system [and what the Council advocated unsuccessfully in the FERC proceeding], i.e., 9%. Thus, the disallowed costs bear no apparent relationship to the savings NOPSI is said to have forgone. [sic] Must not the 'savings' posited as the reason for the disallowance be at least possible in the actual economic market? Furthermore, must not the ultimate disallowance bear some rational relationship to the possible savings which support the disallowance? These questions must be resolved on another day in another court.

109 S.Ct. at 2512, n. 2. This language suggests that the Court meant the pretext claim is inevitably a review of the sufficiency of the evidence to support the Council's stated reasons for denying the pass through. But NOPSI argues the language should be read to require a further inquiry, a determination of the Council members' motivation in making the order, regardless of the evidence. We disagree. We have said that, facially, the Council's order was a valid exercise of its power over retail rates. If there is an adequate basis in the record to support the Council's action, federal courts may not invalidate it on a suspicion that the Council members' motives were improper. See *Fletcher v. Peck,* 6 Cranch. 87, 128–130, 3 L.Ed. 162 (1810); *Arizona v. California,* 283 U.S. 423, 455 n. 7, 51 S.Ct. 522, 526 n. 7, 75 L.Ed. 1154 (1931); *United States v. O'Brien,* 391 U.S. 367, 382–386, 88 S.Ct. 1673, 1681–1684, 20 L.Ed.2d 672 (1968); *Palmer v. Thompson,* 403 U.S. 217, 91 S.Ct. 1940, 29 L.Ed.2d 438 (1971). Of course,

the evaluation of the sufficiency of the evidence must be made with an eye to the circumstances of the case; but beyond that we cannot go. We do not read *NOPSI III* to require otherwise.

Having reached this conclusion, we cannot reverse the district court for failing expressly to consider the relevance of motivation to the pretext claim in deciding to stay its hand. The pretext claim has little functional difference from the state court's sufficiency of the evidence review, and motivation is not relevant. We therefore can reverse only if the district court's order was otherwise an abuse of discretion.

B.

Not all of the factors set out in *Colorado River* and *Moses H. Cone* are important in every case, and only some are important here. In this case, the forums are equally convenient,[8] there is no *res,* and the question of the order in which jurisdiction was actually obtained is confusing and largely academic. We have already determined that there are no substantial federal issues remaining in the case. We therefore focus on the factors that are important —the progress of the proceedings in each forum, the adequacy of the state courts to protect NOPSI's rights, and avoiding piecemeal litigation.

[8]The district court noted that "[t]he factor of convenience usually refers to ease of access of sources of proof, availability of compulsory process, and enforceability of judgments," and that in this sense, neither forum in this case was more convenient than the other. But the court still found the federal forum inconvenient because "it is certainly inconvenient for the parties to pursue two concurrent, parallel litigations in two courts within the same parish in Louisiana." At 996. This approach unnecessarily confuses the analysis. The Court in *Colorado River* plainly considered convenience to mean roughly what it does in *forum non conveniens* analysis, as its reference to *Gulf Oil Corp. v. Gilbert,* 330 U.S. 501, 67 S.Ct. 839, 91 L.Ed. 1055 (1947) indicates. 424 U.S. at 818, 96 S.Ct. at 1246. The other difficulties of proceeding in parallel forums—waste of judicial resources, duplication of effort, expense—are more properly considered in determining whether it is appropriate to stay in order to avoid piecemeal litigation.

The district court was correct that the state proceeding had progressed further than the federal one, since the state trial court had already rendered judgment on the merits of the sufficiency of the evidence claim. The Council's argument that the state trial court's judgment is entitled to res judicata effect is contrary to Louisiana law, see La.Civ.Code Art. 3556(31) (West 1990); but the fact that the state trial court has rendered judgment nonetheless weighs in favor of a stay. There is little to be gained from rehashing the same evidence in another forum.

The state courts are of course quite adequate to protect NOPSI's rights. Indeed, they are more experienced in reviewing retail rate orders than are federal courts. This factor also weighs in favor of a stay.

Colorado River was based primarily upon avoiding piecemeal litigation. Colorado had established a comprehensive system for adjudicating water rights, and it was plain that the relevant federal policies in the McCarran Act favored adjudicating water rights in a single, unified proceeding. 424 U.S. at 819–820, 96 S.Ct. at 1247–1248. The Johnson Act just as clearly evidences a federal purpose to facilitate review of state court retail rate orders in unified proceedings, and indeed in unified proceedings in state court. 28 U.S.C. § 1342; *see Gulf Water Benefaction Co. v. Public Utility Commission,* 674 F.2d 462 (5th Cir. 1982). We have held the Johnson Act not applicable to these proceedings, because the preemption claim was based on the Federal Power Act as well as the Constitution, *NOPSI I,* 782 F.2d at 1242–1243; but that holding does not diminish the federal interest in state court resolution of challenges to state rate orders. Further, it is plain that all necessary parties are before the state court and all claims can be adjudicated there. *See Brillhart v. Excess Insurance Co. of America,* 316 U.S. 491, 495, 62 S.Ct. 1173, 1175, 86 L.Ed. 1620 (1941). The district court thus properly concluded that the desire to avoid piecemeal litigation counselled in favor of a stay.

The district court's discretion to stay decision pursuant to *Colorado River* is perhaps not as broad as was once thought. Compare *Will v. Calvert Fire Insurance Co.,* 437 U.S. 655, 98 S.Ct. 2552, 57 L.Ed.2d 504 (1978) (plurality opinion) and *Moses H. Cone Memorial Hospital,* 460 U.S. at 16–19, 103 S.Ct. at 937–939. The district court of course has broad control over its docket, but that control is limited by the virtually unflagging obligation to exercise its jurisdiction. *See Moses H. Cone Memorial Hospital,* 460 U.S. at 19, 103 S.Ct. at 938. Here, however, three factors counsel strongly in favor of a stay, and there are no substantial federal questions remaining in the case. Under these circumstances, we cannot say the district court abused its discretion.

IV.

Finding no merit in NOPSI's facial preemption challenge, and that the district court properly stayed the pretext challenge, we affirm the judgment of the district court.

AFFIRMED.

AGREEMENT

Among

ARKANSAS POWER & LIGHT COMPANY
ARKANSAS-MISSOURI POWER COMPANY
LOUISIANA POWER & LIGHT COMPANY
MISSISSIPPI POWER & LIGHT COMPANY
NEW ORLEANS PUBLIC SERVICE INC.
MIDDLE SOUTH SERVICES, INC.

THIS AGREEMENT, is made and entered into this 16th day of April 1973, by and among Arkansas Power & Light Company, hereinafter called AP&L; Arkansas-Missouri Power Company, hereinafter called ARK-MO; Louisiana Power & Light Company, hereinafter called LP&L; Mississippi Power & Light Company, hereinafter called MP&L; New Orleans Public Service Inc., hereinafter called NOPSI; and Middle South Services, Inc., hereinafter called SERVICES; all of whose common stock is wholly owned by Middle South Utilities, Inc.

WITNESSETH

0.01 WHEREAS AP&L, ARK-MO, LP&L, MP&L, and NOPSI are the owners and operators of electric generating, transmission and distribution facilities with which they are engaged in the business of generating, transmitting and selling electric energy to the general public and to other electric distributing agencies; and

0.02 WHEREAS SERVICES is an associated Service Company acting as the Agent for the operating companies under the terms of the Middle South Utilities System Agency Agreement and the Middle South Utilities System Agency Coordination Agreement respectively dated the 11th day of December 1970 for AP&L, LP&L, MP&L, and NOPSI and dated the 15th day of September 1971 for ARK-MO; and

0.03 WHEREAS AP&L, ARK-MO, LP&L, MP&L, and NOPSI have been achieving substantial benefits for their customers by operating within the framework of existing interconnection agreements; and

0.04 WHEREAS the individual systems of AP&L, ARK-MO, LP&L, MP&L, and NOPSI are interconnected by transmission lines and operated as a totally coordinated system from a central dispatching center; and

0.05 WHEREAS technological progress and changed economic conditions have necessitated the up-dating of the aforementioned interconnection agreements to continue to obtain the maximum benefits for them and their respective customers;

NOW THEREFORE, the Parties hereto mutually understand and agree as follows:

ARTICLE I

TERM OF AGREEMENT

1.01 This Agreement shall become effective on July 1, 1973, or such later date as may be fixed by any requisite regulatory approval or acceptance for filing. Any Company may terminate its participation in this Agreement by forty-eight (48) months written notice to the other Companies hereto. This Agreement shall continue in force and effect until terminated by mutual agreement of the Companies.

1.02 This Agreement shall supersede the agreements listed below:

(1) Memorandum Re Administration of Intra-System Transactions and System Planning and Development among AP&L, LP&L, and MP&L, dated June 1, 1951.

(2) Agreement between LP&L and NOPSI, dated the 17th day of September, 1956.

(3) Memorandum Re Administration of Intra-System Transactions and System Planning and Development among AP&L and ARK-MO dated October 1, 1971.

1.03 This Agreement will be reviewed periodically by the Operating Committee to determine whether revisions are necessary to meet changing conditions. In the event that revisions are made by the parties hereto, and after requisite approval or acceptance for filing by the appropriate regulatory authorities, the Secretary of the Operating Committee will thereafter, for the purpose of ready reference to a single document, prepare for distribution to the Companies an amended document reflecting all changes in and additions to this Agreement with notation thereon of the date amended.

ARTICLE II

DEFINITIONS

For the purposes of this Agreement and of the Service Schedules which are a part hereof, the following definitions shall apply:

2.01 *Agreement* shall be this Agreement together with all attachments and service schedules applying thereto and any amendments made hereafter.

2.02 *Company* shall be one of the Middle South Utilities System companies whose common stock is owned by Middle South Utilities, Inc. and whose electric utility facilities are interconnected with those of one or more of the Middle South Utilities System companies.

2.03 *Parent Company* shall be Middle South Utilities, Inc.

2.04 *Agent* shall be Middle South Services, Inc. which shall act as Agent for one or more of the Companies whenever appropriate.

2.05 *System* shall be the interconnected coordinated systems of the Companies.

2.06 *Operating Committee* shall be the administrative organization created under this Agreement to administer its provisions.

2.07 *Generating Unit* shall be an electric generator, together with its prime mover and all auxiliary and appurtenant devices and equipment designed to be operated as a unit for the production of electric power and energy.

2.08 *Capability* shall be the net output in megawatts that can be produced by a generating unit under the conditions specified by the Operating Committee, or the input in megawatts available under contract from a supplying source.

2.09 *System Capability* shall be the arithmetical sum in megawatts of the individual Company Capabilities.

2.10 *Company Load Responsibility* shall be as follows:

(a) The average of the four highest clock-hour demands in megawatts of a company's system, each on a different day, occurring during the twelve month period ending with the current month, but not less than 90% of the average of the four highest such demands occurring during the twenty-four (24) month period ending with the current month, where each such demand shall represent the simultaneous hourly input from all sources into the system of a company, less the sum of the simultaneous hourly outputs to the systems of other interconnected utilities. (Company demands shall include firm power supplied to other systems for its own account.)

(b) Less the power supplied to others as sales for the joint account of all the Companies.

(c) Less the contractual amount of firm purchases with reserves available during the month from other systems for its own account.

2.11 *System Load Responsibility* shall be the arithmetical sum in megawatts of the individual Company Load Responsibilities.

2.12 *Responsibility Ratio* shall be the ratio obtained by dividing a Company Load Responsibility by the System Load Responsibility.

2.13 *Capability Responsibility* shall be the System Capability multiplied by the Responsibility Ratio for that Company.

2.14 *Participation Unit* shall be the qualified generating unit or units (either individually owned or jointly owned) most recently installed by a Company where the Company has Capability in excess of its Capability Responsibility.

2.15 *Entitlement Energy* shall be the energy from a Participation Unit to which a Company is entitled by reason of ownership or capability equalization payments. The energy from a Participation Unit shall be allocated among the Companies in the same ratios as their respective shares in the capability of the unit through ownership or capability equalization.

2.16 *Pool Energy* shall be the energy generated or acquired by any Company, in excess of its own requirements, under economic dispatch or as directed by the System Operator, that goes to supply requirements of other Companies.

2.17 *Transmission Responsibility* of a Company shall be the System Inter-Transmission Investment multiplied by the Responsibility Ratio for that Company.

2.18 *Hour* shall be a clock hour.

2.19 *Day* shall be a continuous 24 hour period beginning at midnight CST, or such other time as may be agreed upon by the Operating Committee.

2.20 *Month* shall be a calendar month.

2.21 *Year* shall be a calendar year.

2.22 *Power* shall be the rate of doing work and shall be expressed in kilowatts (KW) or megawatts (MW).

2.23 *Energy* shall be work and shall be expressed in kilowatthours (KWH) or megawatthours (MWH).

ARTICLE III

OBJECTIVES

3.01 The purpose of this Agreement is to provide the contractual basis for the continued planning, construction, and operation of the electric generation, transmission and other facilities of the Companies in such a manner as to achieve the maximum possible economies consistent with the highest practicable reliability of service, with the reasonable utilization of natural resources and effect on the environment, and to provide a basis for equalizing among the Companies any imbalance of costs associated with the construction, ownership and operation of such facilities as are used for the mutual benefit of all the Companies.

3.02 It is recognized by the Companies that economies of scale require that the planning, construction, and operation of the bulk power supply and related facilities of the Companies be on the basis of a single system and that this will dictate the installation of generating units of the larger ratings available at that time, in generating stations of large size, strategically located with regard to fuel and water supply.

3.03 It is recognized that the installation of large generating stations at locations, in many cases, remote from major load centers, will require the installation of additional major high voltage and extra high voltage transmission lines and substations to connect these large generating stations to the major load centers in a manner to assure the highest practicable reliability of service.

3.04 It is recognized that reliability of service and economy of operation require that the energy supply to the system be controlled from a centralized dispatching office and that this will require adequate communication facilities and the provision of economic dispatch computer facilities and automatic controls of generation.

3.05 It is believed, based on experience, that by jointly planning on a system basis for the construction and operation of these major facilities:

(a) the combined loads of the Companies can be supplied with less aggregate installed capacity; and

(b) Installations of additional capacity can be made at lower cost because of the large unit sizes; and

(c) The new installations will be more economical and require less operating labor and maintenance per KW because of the larger unit sizes; and

(d) The strengthened transmission system will make possible a fuller utilization of the capability of the lower cost generating units of the System; and

(e) Emergency conditions in any part of the System or other systems in adjacent areas can be met with less probability of impairment of service to the general public.

3.06 It is therefore intended that, under this Agreement, each Company shall be willing and able to provide its portion of the major facilities determined to be necessary and that each Company shall share in the benefits and pay its share of the costs of coordinated operations as agreed upon in accordance with Service Schedules to be attached hereto from time to time and made a part hereof.

ARTICLE IV

OBLIGATIONS

4.01 *Production Facilities*

Each Company shall normally own, or have available to it under firm contract, such generating capability and other facili-

ties as are necessary to supply all of the requirements of its own customers, except that, as may be determined from time to time, in the interest of economy and efficiency, generating capability in excess of normal requirements may be installed by one Company for the use and benefit of the customers of the other Companies.

Each Company shall furnish the Operating Committee, at the time and in the manner designated, estimates of its annual peak load for the next succeeding 10 year period, or such period as may be required, together with estimates of its capability available from generating units in operation, under construction or already approved and capability available from other sources under contract.

The Operating Committee shall then determine a generation addition plan to provide capacity for the projected system load. The purpose of the plan will be to provide capacity for the forecasted firm power requirements of customers to be served by each of the Companies. Any additional large blocks of power sales anticipated should be submitted to the Operating Committee at least seven years before needed in order that appropriate capacity can be scheduled into the generation addition plan. The Operating Committee may, at its discretion, permit the addition of such sales on a shorter schedule if it deems the serving of such load practicable and economically feasible within the available time.

Each Company to whom the Operating Committee assigns a Generating Unit for installation will make the necessary financial arrangements and promptly proceed with the design and construction of the unit to meet the "in service" date agreed upon in accordance with the plan.

Any Capability in excess of the Capability Responsibility of a Company that may exist in the system of one or more Companies as a result of installation of facilities in accordance with the pro-

visions of the generation addition plan shall be equalized among the Companies in accordance with the provisions of the applicable Service Schedule.

4.02 *Purchased Power & Energy*

The Companies, with the consent of the Operating Committee, may agree to a contract by one or more of them, for the purchase of power and energy from outside sources for the account of a Company or Companies.

If purchased by a Company for its own account, the power shall be included by the purchasing Company in its Capability to the extent provided by the applicable Service Schedule. The energy purchased shall be considered as part of the purchasing Company's energy supply.

If purchased by a Company for the joint account of less than all of the Companies, the power and energy shall be allocated among the purchasing Companies in any manner mutually agreeable to them.

If purchased by a Company for the joint account of all the Companies, the power and energy shall be allocated to each Company in proportion to its Responsibility Ratio in effect as of the preceding October 31st and this Responsibility Ratio for this purpose shall remain in effect until the following October 31st. Each Company shall include its allocated portion of the power, so purchased, in its Capability to the extent provided by the applicable Service Schedule and shall include its portion of the energy so purchased in its energy supply. Each Company shall pay for power and energy allocated to it hereunder at the rates paid by the Company making the purchase.

4.03 *Power and Energy Exchanged with Outside Systems*

Power and energy may be delivered to or received from an outside system under agreements providing for a return in kind.

The accounting for such deliveries and receipts shall be as follows:

(a) If the System supplies first, the obligation to supply shall be prorated to each Company in proportion to its Responsibility Ratio in effect as of the preceding October 31st, and the power and energy which each Company is entitled to receive in return shall be equal to the obligation to supply.

(b) If the System receives first, the power and energy to be received shall be prorated to each Company in proportion to its Responsibility Ratio in effect as of the preceding October 31st, and each Company shall be obligated to supply in return the amount of power and energy that it was entitled to receive.

4.04 *Sales to Others for the Joint Account of All the Companies*

Sales of power and energy to others for which any Company does not wish to assume sole responsibility, shall, by mutual consent of the Companies, be made by the Company having direct connection with such others, for the joint account of all the Companies, and the net balance derived from such sales shall be divided among the Companies as provided in the applicable Service Schedule.

4.05 *Transmission Facilities*

The Companies own and operate extensive transmission systems traversing their operating areas and interconnecting with each other, as well as with the transmission systems of adjacent utilities.

It is agreed that portions of each Company's bulk power transmission system shall be equalized in accordance with the applicable Service Schedule so that the ownership costs of those transmission facilities shall be distributed equitably among the Companies.

The Operating Committee shall make studies of bulk power transmission facilities and agree upon the facilities that will be required to transmit the power supply from generating or other sources to the load centers. The facilities agreed upon shall be built to comply with a time schedule determined by the Operating Committee and shall be adequate to provide the bulk power transmission system requirements with due allowances for contingencies that may reasonably be expected. The Operating Committee shall agree on the general routes of bulk power transmission lines, the voltages and conductor sizes, and the location of substations which are covered by this Agreement.

4.06 *Communication and Other Facilities*

The Companies shall provide communication and other facilities, determined by the Operating Committee to be necessary for metering, control, protection and dispatch of the production and transmission facilities, and for such other purposes as may be necessary or desirable for the operation of the Companies' Systems.

4.07 *Dispatch*

Under general direction of the Operating Committee, SERVICES will construct, own and operate a centralized operations center properly equipped and staffed to dispatch the power and energy requirements of the Companies, in the efficient, economical, and reliable manner contemplated by this Agreement. All generating units, included in System Capability under this Agreement, presently in operation or installed in the future, shall be equipped with such controls as may be determined by the Operating Committee to be necessary to accomplish such centralized economic dispatch.

It is recognized by the Companies that, because of such economic dispatch, a Company may not, at all times, be supplying the energy requirements of its system, but may be taking energy

from the resources of the other Companies or supplying energy to the other Companies. The payments or charges for such energy exchange shall be as provided in the applicable Service Schedule.

4.08 *Records and Reports*

SERVICES shall keep such records as may be necessary for the efficient administration of this Agreement, and shall make such records available to any Company on request. Each Company shall make all reports requested by the Operating Committee within the time prescribed.

4.09 *Regulatory Authorization*

This Agreement is subject to certain regulatory approvals and each Company shall diligently seek all necessary regulatory authorization for this Agreement and the performance of its obligations thereunder.

4.10 *Effect on Other Agreements*

This Agreement shall not modify the obligations of any Company under any Agreement between that Company and others not parties to this Agreement in effect at the date of this Agreement.

4.11 *Service Schedules*

The bases of compensation for the use of facilities and for the power and energy provided or supplied by a Company to another Company or Companies under this Agreement shall be in accordance with arrangements agreed upon from time to time among the Companies. Such arrangements shall be in the form of Service Schedules, each of which, when signed by the parties hereto, and approved or accepted by appropriate regulatory authority shall become a part of this Agreement.

Each Company reserves the right to seek unilaterally amendments or changes in the terms and conditions of service and increases or decreases in the rates and charges provided in the Service Schedule from any regulatory body having or acquiring jurisdiction thereover.

4.12 *Measurements*

All power and energy measurements, such as between the systems of the Companies, shall be made at or corrected to the points of interconnection unless otherwise agreed to by the Operating Committee.

4.13 *Billings*

Bills for services rendered hereunder shall be calculated in accordance with applicable Service Schedules, and shall be issued on the fifth working day of the month following that in which such service was rendered and shall be payable on or before the 15th day of such month. After the 20th day, interest shall accrue on any balance due at the rate of eight percent (8%) per annum until paid, or at such other rates as established by the Operating Committee.

4.14 *Waivers*

Any waiver at any time by a Company of its rights with respect to a default by any other Company under this Agreement, shall not be deemed a waiver with respect to any subsequent default.

4.15 *Successors and Assigns*

This Agreement shall inure to the benefit of and be binding upon the successors and assigns of the respective Companies hereto, but shall not be assignable by any Company without the written consent of the other Companies, except upon foreclosure of a mortgage or deed of trust.

4.16 *Amendment*

This Agreement may be changed, amended, or supplemented, only by an instrument in writing, signed by all the Companies.

4.17 *Independent Contractors*

It is agreed among the Companies that by entering into this Agreement providing for the coordinated planning, construction and operation of power production, transmission, communications and other facilities of the Companies, the Companies shall not become partners, but as to each other and to third persons, the Companies shall remain independent contractors in all matters relating to this Agreement.

4.18 *Responsibility for Loss or Damage*

Each Company shall defend, indemnify, and save harmless the other Companies, against liability, loss, costs and expenses on account of any injury or damage to persons or property occurring on or in connection with its facilities on its side of any of the points of interconnection, except to the extent such injury or damage was caused by the sole or contributory negligence of another Company, its agent or employees.

ARTICLE V

Composition and Duties of the Operating Committee

5.01 *Operating Committee*

An Operating Committee shall be the administrative organization under this Agreement and shall consist of one member designated by the chief executive officer of each Company and one member designated by the chief executive officer of the Parent Company. Such designation shall be by written notice to the Secretary of the Operating Committee with copies to each of the other Companies. Each Company and the Parent Company may change its designated member at any time by written notice to the Secretary of the Operating Committee and each of the other Companies.

5.02 *Officers of the Operating Committee*

The Operating Committee shall have the following officers with duties as designated:

(a) *Chairman*—The Chairman shall issue calls for and shall preside at meetings of the Operating Committee. He shall have responsibility for the general coordination of the Operating Committee functions among the various members.

(b) *Vice Chairman*—The Vice Chairman shall perform the duties of the Chairman in his absence or incapacity.

(c) *Secretary*—The Secretary shall be responsible for keeping the minutes of the meetings of the Operating Committee and for preparing copies thereof and for distributing them to the Companies.

The Secretary shall be responsible for the filing of this Agreement, and any amendments thereto and any exhibits required, with the Federal Power Commission and for distributing copies of such filings to the Companies.

The Secretary shall be responsible for obtaining written approval from the Companies for any acts or decisions of the Operating Committee which may require such written approval, and shall be responsible for distributing copies of such approvals to the Companies.

The Chairman and Vice Chairman shall be elected from the members by majority vote at the first meeting held in each calendar year and shall take office immediately upon being elected.

The Secretary shall be designated by the Operating Committee.

5.03 *Meeting Dates*

The Operating Committee shall hold meetings at least quarterly and at any time upon the request of a member, and shall keep minutes of its proceedings.

5.04 *Decisions*

All decisions of the Operating Committee shall be by a two-thirds majority vote. For the purposes of voting, the Parent Company, through its representative shall have twenty (20) percent of the vote and the remaining eighty (80) percent shall be divided among the Companies in proportion to each Company's Responsibility Ratio in effect as of the preceding October 31st.

5.05 *Attendance at Meetings*

Each Company and the Parent Company shall be represented at each Operating Committee meeting by its member on the Committee or a proxy designated by the member or his chief executive officer. Such proxy shall not necessarily be an employee of the Company represented.

5.06 *Duties*

The Operating Committee shall:

(a) Make the studies required to fulfill the obligations agreed to in the Article IV of this Agreement, and its decisions shall become the basis for the installation of generation, bulk power transmission, communication, and other facilities necessary for the supply of power and energy to the System.

(b) Determine the amount of and require installation of adequate reserves for System Capability to assure, insofar as practicable, the continuous supply of power and energy to the major load centers of the System.

(c) Establish safe loading criteria for generating units, transmission lines and any other facilities necessary for the supply of power and energy to the major load centers of the System.

(d) Promulgate whatever standards may be required for the safe and reliable operation of the System.

(e) Consult with and provide general supervision for SERVICES in employing and supervising a System Operator and provide for such assistance as needed.

(f) Determine the need for and generally supervise the keeping of records and the making of such reports as are deemed necessary or appropriate.

(g) Determine the need for and generally supervise communications, interchange and load control, metering, economic dispatch and relaying facilities necessary for the purpose of this Agreement.

(h) Make any determinations required for the purpose of administering any schedules subject to its administration.

(i) Study and determine from time to time additions or changes in facilities necessary to keep abreast of the production and transmission requirements of the System.

(j) Provide for and coordinate safe dispatching, switching and other routine procedures.

(k) Provide for equitable distribution of spinning reserves and the supply of reactive KVA.

(l) Establish, amend, supplement or terminate from time to time rules, procedures or practices as necessary to insure functioning of the System within the scope of this Agreement.

(m) Coordinate negotiations with others from time to time for interchange and sale of power and energy.

(n) Coordinate arrangements for the sale and delivery to others on a profitable basis, of power and energy not required for System purposes.

(o) Coordinate arrangements from time to time to procure for the Companies, or for their account, such power and energy from external sources as may be required or will result in savings to the Companies.

(p) Keep abreast of all environmental factors as they affect the operation of the System in order to comply with all established criteria for minimizing pollution.

(q) Undertake any other duties that may from time to time be assigned to it or deemed appropriate.

5.07 *Employment of Consultants*

The Operating Committee, in the performance of its duties, may employ such technical and consulting services as warranted.

5.08 *Expenses of Committee*

Each Company (except the Parent Company) shall pay all expenses of its representatives on the Operating Committee. The expenses of the representative of the Parent Company shall be paid by SERVICES. Any other expenses of the Committee shall be prorated among the Companies as determined by the Operating Committee.

ARTICLE VI

System Operations Center

6.01 *System Operations Center*

The operation of the System shall be controlled by the System Operations Center which will be owned and operated by SERVICES.

6.02 *Duties*

SERVICES through the System Operations Center shall:

(a) Determine the most effective scheduling of sources for the reliable supply of power and energy on an economical basis to the system.

(b) Supervise the operation and maintenance of computer facilities specified by the Operating Committee for the following purposes:

1. Economic system dispatch,

2. Determination of billing information,

and

3. Determination of other data required by the Operating Committee.

(c) Supervise safe switching procedures and other routine procedures in the System.

(d) Determine the availability of energy for purchase from or sale to outside systems on an economical basis under existing contracts and arrange for and schedule such transactions.

(e) Coordinate the operation of communication facilities owned or leased by the Companies to provide the communication essential to the safe, reliable and economical operation of the System.

(f) Maintain such records and prepare such reports as the Operating Committee designates.

6.03 *Expenses*

The expenses incurred in the operation of the System Operations Center shall be in accordance with a budget approved by the Operating Committee, and revisions thereto, or separate approvals by the Operating Committee. All expenses of the System Operations Center shall be paid by SERVICES and billed monthly to each Company in accordance with the applicable Service Schedule.

IN WITNESS WHEREOF each of the Companies has caused these presents to be signed in its name and on its behalf by its President, attested by its Secretary, both being duly authorized.

ARKANSAS POWER & LIGHT COMPANY

Attest

/s/ HELEN C. LEFTWICH
ASSISTANT Secretary

By /s/ REEVES E. RITCHIE
President

ARKANSAS-MISSOURI POWER COMPANY

Attest

/s/ CHAS. R. NEWCOMB
Secretary

By /s/ F.G. SMITH
President

LOUISIANA POWER & LIGHT COMPANY

Attest

/s/ W.H. TALBOT
Secretary

By /s/ E.A. RODRIGUE
President

MISSISSIPPI POWER & LIGHT COMPANY

Attest

/s/ FRANK S. YORK, JR.
Secretary

By /s/ D.C. LUTKEN
President

NEW ORLEANS PUBLIC SERVICE INC.

Attest

/s/ VICTOR LOTA
Secretary

By /s/ WILLIAM MCCOLLAM, JR.
President

MIDDLE SOUTH SERVICES, INC.

Attest

/s/ D.E. STAPP
Secretary

By /s/ F.W. LEWIS
President

RESOLUTION
R-88-14

CITY HALL: FEBRUARY 4, 1988

BY: COUNCILMEMBERS BOISSIERE, EARLY, GIARRUSSO, JACKSON, SINGLETON, TAYLOR AND WILSON

IN THE MATTER OF
EX PARTE APPLICATION OF
NEW ORLEANS PUBLIC SERVICE INC.
FOR AN INCREASE IN ITS ELECTRIC RATES,
DOCKET NO. CD-85-1 (PRUDENCE INQUIRY)

WHEREAS, on October 10, 1985, the Council issued Resolution R-85-636 instituting a formal investigation of the prudence of the management of New Orleans Public Service Inc. ("NOPSI") with respect to the company's involvement in the Grand Gulf Unit No. 1 nuclear plant ("Grand Gulf"); and

WHEREAS, formal evidentiary hearings in connection with this prudence investigation of NOPSI were subsequently conducted before our designated Presiding Officer and Hearing Examiner, Mr. John M. Farmakides, in April and October 1986, and February 1987, followed by the transmittal of the formal evidentiary record to the Council by Mr. Farmakides in April 1987 and briefs by certain parties herein; and

WHEREAS, a public hearing on the matter of the prudence of NOPSI's management with respect to the company's involvement in Grand Gulf was conducted before the Council on October 23, 1987 to, in part, permit the parties to summarize their positions on the record evidence below; and

WHEREAS, a companion Determinations and Order in this Docket has been prepared to constitute and reflect the Council's

findings and decision as to the prudence of NOPSI's management and the remedy based on such findings and decision; and

WHEREAS, on the basis of the formal record before us, it is the Council's opinion that NOPSI's management failed, in its actions, to fully protect the interests of its ratepayers, and the company's conduct fell short of prudent utility management, to the detriment of its ratepayers and shareholders, the reasons and basis for which are fully explained and discussed in the Council's Determinations and Order hereby adopted; and

WHEREAS, on the basis of the record evidence regarding economic impact of possible remedies for imprudence before us, it is the Council's determination that a one-time disallowance of and write-off of a sum equal to $135 million in NOPSI's deferred Grand Gulf I expense should be ordered and NOPSI's rate increases in 1988 and beyond, as specified in Resolution R-86-112 (the March 1986 Partial Settlement between the Council and NOPSI) should be reduced to reflect the $135 million disallowance, the reasons and basis for which are fully explained and discussed in the Council's Determinations and Order attached hereto and made a part hereof; now, therefore,

BE IT RESOLVED BY THE COUNCIL OF THE CITY OF NEW ORLEANS, that the companion Determinations and Order in this docket which are attached hereto and made a part hereof, constitutes our final order and decision, and is adopted by the Council and issued as our formal findings of fact and conclusions thereupon as justified by the record, to be effective as of the date of issuance of this resolution.

THE FOREGOING RESOLUTION WAS READ IN FULL, THE ROLL WAS CALLED ON THE ADOPTION THEREOF AND RESULTED AS FOLLOWS:

YEAS: Boissiere, Early, Giarrusso, Jackson, Singleton, Taylor, Wilson—7

NAYS: 0

ABSENT: 0

AND THE RESOLUTION WAS ADOPTED.

The foregoing is certified to be a true and correct copy.

/S/ EMMA J. WILLIAMS
Clerk of Council
City of New Orleans

IN THE MATTER OF EX PARTE APPLICATION OF NEW ORLEANS PUBLIC SERVICE INC. FOR AN INCREASE OF ITS ELECTRIC RATES (DOCKET NO. CD 85-1)

PRUDENCE INVESTIGATION: DETERMINATIONS AND ORDER REGARDING THE PRUDENCE OF THE MANAGEMENT OF NEW ORLEANS PUBLIC SERVICE INC. WITH RESPECT TO GRAND GULF 1

COUNCIL OF THE CITY OF NEW ORLEANS

Dorothy M. Taylor
Joseph I. Giarrusso
Lambert Boissiere, Jr.
Mike Early
Johnny Jackson, Jr.
James Singleton
Peggy Wilson

The Foregoing is Certified To Be A True and Correct Copy

/s/ Emma J. Williams
Clerk of Council
City of New Orleans

Date: February , 1988

/s/ Lambert Boissiere, Jr.
/s/ Peggy Wilson
/s/ James M. Singleton
/s/ Mike Early

/s/ Johnny Jackson, Jr.
/s/ Joseph I. Giarrusso

TABLE OF CONTENTS

		Page
I.	INTRODUCTION	63
	A. Authority of the Council	63
	B. Events Leading to These Proceedings	65
	C. The Proceedings	68
II.	SUMMARY OF THE FINDINGS OF THE COUNCIL	70
III.	PRELIMINARY MATTERS	73
	A. Litigation and Procedural Disputes	73
	B. Efforts to Block Discovery	78
	C. Due Process Issues	84
IV.	LEGAL STANDARDS IN THESE PROCEEDINGS	88
	A. The Purpose of and the Standards Governing This Prudence Investigation	88
	1. Standard of Prudence	90
	2. Burden of Proof	94
	B. Federal Preemption	97
PART B.	DETAILED PRUDENCE ANALYSIS	105
V.	STATEMENT OF FACTS	105
	A. The Middle South System	105
	1. Overview	105
	2. SEC Approval of the Middle South Reorganization Plan	106
	3. History of System Agreements	110
	4. Generation Planning On The System	113
	5. Cost Allocation Under The 1973 System Agreement	115
	6. Impact of Generation Decisions on Relative Company Costs	119

		Page
B.	NOPSI's Generation Needs And Projections in 1974	122
C.	The System's Generation Needs And Projections In 1974	123
D.	Decision to Build Nuclear Plants—Including Grand Gulf—And Coal Plants	124
E.	Commitments To Grand Gulf Under The Availability Agreement	126
F.	Generation Capacity Additions By Other Operating Companies In The 1970's	129
G.	Cost Estimates And Forecasting	132
H.	Nuclear Plant Cost-Estimation Techniques	133
I.	Growing Concern Over Gas And Oil As Generation Fuels	134
J.	The Three Mile Island Incident	135
K.	NOPSI's Decision To Take A Large Fixed Share Of Grand Gulf	136
L.	1980 Hearings Before The Council	141
M.	Determinations By The FERC	143
N.	Grand Gulf Operations And Costs; Attempts To Dispose Of Grand Gulf	149
O.	NOPSI Files Application For Increased Rates	150
PART C.	PRUDENCE ANALYSIS	154
VI.	ANALYSIS OF PRUDENCE ISSUES	154
A.	NOPSI's 1974 Indeterminate Commitment to Grand Gulf	155
B.	NOPSI Failed to Maintain Prudent Oversight Of Its Grand Gulf Obligations	161

		Page
C.	NOPSI Failed to take Prudent Actions in the Critical 1979-1980 Time Frame	167
	Summary of Analysis	167
1.	During 1979, the Situation Changed Radically	167
2.	What NOPSI Did and Failed to Do	168
3.	What NOPSI Should Have Done	170
	Detailed Analysis	171
4.	NOPSI's Failure to Deal Realistically with the Rising Cost of Grand Gulf; the "Ostrich" Policy	171
5.	NOPSI's Failure to Deal With the Impact of the Three Mile Island Incident	180
6.	NOPSI Should Have Realized, in 1979, that the Cost of Grand Gulf Power Would Be Uneconomic	192
a.	Capital Additions	192
b.	Operation and Maintenance Costs	193
c.	Pricing Coal-Fired Alternatives	194
d.	NOPSI's Selective Use of Cost Assumptions	195
e.	Role of Grand Gulf II	196
7.	NOPSI Should Have Sought to Reduce its Grand Gulf Risk	197
8.	NOPSI Failed to Explore and Take Advantage of Opportunities to Purchase Coal-Fired Capacity as an Alternative to Nuclear Power	203
VII.	EVIDENCE REGARDING ECONOMIC IMPACT OF POSSIBLE REMEDIES	208
A.	Procedural Background	208
B.	Overview	209

Page

C. The Financial Projections: Directions and Assumptions 212

1. NOPSI's contention that the Settlement Agreement precludes prudence relief; issues of investor reliance and retroactive ratemaking 217

2. NOPSI's contention that the financial forecasts are based on the unreasonable assumption that the Council would grant regular annual rate relief sufficient to maintain a 14% return on average common equity 224

3. NOPSI's contention that the forecasts are based on the unreasonable assumption that NOPSI could obtain debt financing at the rate of 11%; and its further contention that it could not obtain debt financing on any reasonable terms 227

4. NOPSI's contention that it is unreasonable to assume that MSU will make the equity investment in NOPSI required to fulfill the financial projection 231

5. NOPSI's contention that the Tax Reform Act of 1986 is so adverse that NOPSI could not sustain a significant imprudence deduction even if it could have done so under the prior tax law 235

6. NOPSI's contention that there are no additional measures available to aid NOPSI in its financing in the event of an imprudence deduction 237

VIII. IMPRUDENCE DISALLOWANCE 241

CITY HALL:_____

BY: COUNCIL MEMBERS TAYLOR, GIARRUSSO, BOISSIERE, EARLY, JACKSON, SINGLETON AND WILSON

IN THE MATTER OF EX PARTE APPLICATION OF NEW ORLEANS PUBLIC SERVICE INC. FOR AN INCREASE OF ITS ELECTRIC RATES · (DOCKET NO. CD 85-1)

PRUDENCE INVESTIGATION: DETERMINATIONS AND ORDER

I. *INTRODUCTION*

The Council has undertaken an investigation of the prudence of the management of New Orleans Public Service Inc. ("NOPSI") with respect to NOPSI's involvement in the Grand Gulf Unit No. 1 nuclear-fueled electric generating station ("Grand Gulf I"), which is part of a larger project involving a second unit ("Grand Gulf II"). This investigation is an outgrowth of the ratemaking proceeding initiated by NOPSI's filing of an application with the Council on May 17, 1985 for a rate increase to reflect its share of the costs of Grand Gulf I. It was formally instituted by Resolution R-85-636, adopted October 10, 1985.

A. *Authority of the Council*

The Council has conducted this prudence investigation under its authority as regulator of NOPSI's rates and operations. Pursuant to Section 4-1604 of the Home Rule Charter of the City of New Orleans, the Council is invested with "all powers of supervision, regulation and control over any street railroad, electric, gas, heat, power, waterworks, and other public utilities within the

City of New Orleans."[1] The Council's regulatory power is recognized by the Louisiana Constitution of 1974, which excludes from the authority of the Louisiana Public Service Commission ("LPSC") a public utility otherwise regulated by a political subdivision of the state. La. Const. Art. 4, Section 21(b) and (e).

NOPSI's rights and obligations with respect to the provision of electric service in New Orleans derive from a series of events and enactments beginning in 1921. The Louisiana Constitution of 1921 granted to the City of New Orleans the right and authority to "perform all of the acts pertaining to its local affairs, property and government, which are necessary or proper in the legitimate exercise of its corporate power and municipal functions." La. Const. of 1921, Art. 14, Section 22. Also in 1921, the Louisiana legislature authorized certain cities, including New Orleans, to gra franchises to public utilities and to regulate them. The per- tute, La. Rev. Stat. Ann. § 33:4405, read in part:

> governing authority of every city having a population of one hundred thousand or more may grant indeterminate permits for the use of the streets and other public places in connection with the operation and maintenance of any public utility. . . .[and] may prescribe, stipulate, or agree to such other conditions of the permits as it deems proper. Any violation of any of the conditions shall be sufficient grounds for forfeiture of the permit, in which event or for other legal cause, the city may sue for its forfeiture, cancellation, or revocation or, at its option, may sue for its enforcement with damages suffered . . .

Before the creation of NOPSI, the New Orleans Railway & Light Company provided electric service to the City of New Orleans. On April 21, 1922, the Commission Council of the City of New Orleans, in connection with the reorganization of the latter company, passed Ordinance No. 6822, which set forth the terms and conditions under which NOPSI was to be franchised. Among the conditions was the requirement that the Commission Council "will at all times require the properties to be efficiently and economically managed and operated." Ord. No. 6822, Sec. 2.

On September 2, 1922, the Commission Council enacted Ordinance No. 7068, which officially enfranchised NOPSI. Under the terms and conditions of that ordinance, NOPSI was "entitled and authorized to charge and collect such fair and reasonable rates for electrical energy furnished and delivered in the City of New Orleans as may be established by the City of New Orleans and/or other regulatory authority in accordance with law." Ord. No. 7068, Sec. 4. NOPSI's authority to operate and to collect rates thus derives entirely from the acts and authority of the City Council and its predecessor, the Commission Council.

B. *Events Leading to These Proceedings*

NOPSI is one of several wholly-owned subsidiaries of Middle South Utilities, Inc. ("MSU") and is engaged in the retail sale of electricity to consumers in New Orleans (other than the 15th Ward, Algiers). Grand Gulf I is a 1250 megawatt nuclear generating plant located in Port Gibson, Mississippi, a 90% ownership interest in which is held by System Energy Resources, Inc. ("SERI") (the corporate name of which formerly was Middle South Energy, Inc. ("MSE")), another wholly-owned subsidiary of MSU. Originally projected to cost $875 million, Grand Gulf I entered commercial operations in July of 1985 at a cost in excess of $3.6 billion.

NOPSI became involved in the Grand Gulf project in 1974 when, without informing the Council, it entered into the first of a series of agreements with MSE and other MSU-owned operating

[1] With the exception of a brief period, the Council has exercised regulatory jurisdiction over NOPSI since 1922. On November 23, 1981, pursuant to Ordinance No. 8264 (adopted by the Council on August 6, 1981), a referendum of the voters caused regulatory authority over NOPSI to be transferred to the Louisiana Public Service Commission ("LPSC"). Such powers were returned to the Council by a referendum of the voters on May 4, 1985. Formal transfer of powers from the LPSC to the Council took place on May 15, 1985.

companies, pursuant to which it joined in providing the basis for the financing of the plant by agreeing to pay part of its costs and purchase a portion of its output. Neither these nor subsequent agreements appear to have been the result of arms-length bargaining and they were not approved by the Council.

The Council first became aware of the potential impact of Grand Gulf on NOPSI and New Orleans' ratepayers after NOPSI had already committed in 1980 to take a 29.8% share of Grand Gulf I. In September 1980, a hearing was held before the Council on NOPSI's application for a capacity adjustment clause that would have allowed NOPSI automatically to pass through its Grand Gulf costs to the ratepayers without additional action by the Council. NOPSI's Chief Executive Officer, James M. Cain, testified then that New Orleans' ratepayers would *not* have to pay for Grand Gulf should the Council deem it inappropriate, and that NOPSI would instead sell its Grand Gulf power to other utilities.

In 1983, Grand Gulf I became the subject of proceedings before the Federal Energy Regulatory Commission ("FERC"), which exercises jurisdiction over the sale of electricity at wholesale in interstate commerce pursuant to the provisions of the Federal Power Act, 16 U.S.C. § 8 *et seq*. In Opinions No. 234 (31 FERC ¶ 61,943) and No. 234A (32 FERC ¶ 61,424), issued on June 13, 1985 and September 26, 1985, respectively, the FERC found that the share of Grand Gulf I accepted by NOPSI's management was unreasonable and excessive. The FERC allocated the capacity and cost responsibility of Grand Gulf I among NOPSI and the other MSU-owned operating companies as follows: Arkansas Power & Light Company ("AP&L")—36%; Louisiana Power & Light Company—14%; Mississippi Power & Light Company ("MP&L")—33%; NOPSI—17%. The FERC's decision was reversed and remanded for reconsideration of these allocations. *Mississippi Industries v. Federal Energy Regulatory Commission*, 822 F.2d 1104 (D.C. Cir. 1987), *cert. denied*, 56 U.S.L.W. 3414

(1987). Recently, the FERC issued a further decision on remand in which the agency reaffirmed its prior allocation. *System Energy Resources, Inc.*, Opinion No. 292, 41 FERC ¶ ——— (Nov. 30, 1987).

While the FERC's decision requires that NOPSI be responsible for 17% of Grand Gulf I costs, the FERC did not address the question of how or in what manner such costs should be recovered through NOPSI's retail electric rates. Nor did the FERC address the prudence of the management of NOPSI or other individual operating companies with respect to Grand Gulf; problems associated with possible "rate shock" threatened by the magnitude of the costs; the need for "phased-in" retail rate approaches; or other matters relating to retail rates. The decision of the FERC is addressed later in more detail.

Following the FERC's decision, NOPSI initiated a retail ratemaking proceeding by filing an application for retail rate relief with the Council on May 17, 1985. NOPSI requested the Council's permission to increase its electric rates for the principal purpose of paying capital-related expenses associated with its share of Grand Gulf I, approximately $168 million per year.

After several hearings and extensive federal court litigation, described *infra*, the Council on March 20, 1986, adopted Resolution No. R-86-112, which accepted, subject to certain modifications, a settlement proposal advanced by NOPSI with respect to its application for permanent rate relief. The settlement required that NOPSI's shareholders absorb approximately $51.2 million of Grand Gulf I costs and provided that remaining costs would be phased-in as retail electric rates over approximately 12 years, with annual rate increases limited to approximately 6 percent. The settlement assured that the full Grand Gulf I expenses would not be immediately passed through to ratepayers, an event that would have resulted in an immediate retail rate increase of 60 percent or more and would have subjected the New Orleans com-

munity to severe "rate shock."[2] Moreover, the settlement expressly provided that it did not curtail the Council's right to conduct this proceeding concerning the prudence of NOPSI's involvement in the Grand Gulf project; to municipalize the electric service by acquisition of NOPSI's assets; or to pursue a lawsuit pending in state court regarding the possible abrogation of NOPSI's Grand Gulf contracts.

C. *The Proceedings*

The active participants in this prudence investigation have included NOPSI, legal and technical consultants retained by the Council, and one intervenor, Citizens for Safe Energy, Inc. After the close of evidence on the substantive issue of imprudence, the Attorney General of the State of Louisiana sought and was given permission to intervene. His position was limited to the remedy phase of this proceeding and is described later. Members of the public also have been permitted, at various Council meetings, to express their views regarding the issues involved in the general rate proceeding.

The evidentiary portion of this investigation was conducted in two phases. The first phase was devoted to the substantive issues bearing upon the prudence of NOPSI's management. The second phase focused on the appropriate remedy to be imposed in the event imprudence were found. During the first phase NOPSI filed prepared testimony, including exhibits, on December 16, 1985. Thereafter, expert consultants retained by the Council submitted prepared testimony on March 19, 1986. NOPSI submitted prepared rebuttal testimony on March 31, 1986. Depositions were taken of 17 persons, including the proposed witnesses and others.

[2]There was testimony in the rate case that immediate implementation of the rate increase proposed by NOPSI would have resulted in the loss [of] over 6,000 jobs, pushed the income of 1,760 families below the poverty line, made it impossible for over 1,100 otherwise qualified families to qualify for mortgage loans, and otherwise would have had a profound adverse impact on the community.

Hearings were conducted before a Hearing Examiner appointed by the Council, John B. Farmakides, formerly an official of the federal Nuclear Regulatory Commission, and extended over a period of eight days between April 4 and 14, 1986. This phase of the proceedings resulted in an extensive evidentiary record comprising more than 100 exhibits (including all the depositions taken) and about 2000 pages of hearing transcript.

During the second phase of the proceeding, which focused on the possible remedies and their economic impact if imprudence were found, NOPSI and the City's consultants filed additional prepared testimony in September and October 1986. Further hearings were conducted before the Hearing Examiner in the period October 21 to 24, 1986. Additional testimony regarding the impact of the Tax Reform Act of 1986 was submitted in February 1987, and a final hearing was held on February 24, 1987. The record was thereafter officially closed, and a certified index was submitted to the Council on April 16, 1987. On October 23, 1987 the Council conducted a public hearing on the prudence inquiry, at which the participants were given the opportunity to present their views. Issuance of a decision in this matter was necessarily delayed during the pendency of settlement negotiations and by other intervening utility matters which occupied the Council's attention.

Appendix A hereto is an index of the evidentiary record for the first phase of the proceeding, prepared and submitted by the Hearing Examiner. Appendix B hereto is the Hearing Examiner's index of the evidentiary record for the second phase of the proceeding. References to pages in the transcript are in the form "Tr. ____." References to exhibits are in the name of the party originating or sponsoring the exhibit, often followed by a page number (e.g., "NOPSI Exh. 36 at 17" or "CNO Exh. 5 at 142").

Attached as Appendix C is a list of the witnesses in this proceeding and others playing a significant role in the events under review, along with a brief biographical treatment of each.

II. *SUMMARY OF THE FINDINGS OF THE COUNCIL*

On the basis of this record, we have reached the following findings and conclusions as to the actions of NOPSI's management with respect to Grand Gulf:

1. In 1974, NOPSI's management committed to an indeterminate responsibility to pay for Grand Gulf, such that it did not know the amount of power and energy for whih NOPSI would be responsible or NOPSI's cost exposure. It did so virtually without placing any limits on NOPSI's liability. The share of Grand Gulf for which NOPSI might be ultimately responsible was subject to factors beyond the control of NOPSI's management. While it may well have been necessary and proper for NOPSI to secure new sources of additional capacity in 1974, the indeterminate and uncontrollable nature of its commitment to one massive project cannot be squared with sound or prudent management. Moreover, the indefinite nature of contractual commitments undertaken at the outset of the project became part of the factual record that permitted the FERC to allot a 17 percent share of Grand Gulf I to NOPSI despite its much smaller relative size among the operating companies.

Because of the FERC's determination, which legally establishes NOPSI's share of Grand Gulf I, we do not, however, alter or interfere with that allocation or base any monetary remedy on the foregoing finding of imprudence. Although we disagree vigorously with the size of the FERC's allocation to NOPSI and will continue to contest that allocation in federal court proceedings, we are obligated to accept it for this proceeding as binding on the company and as the authoritative establishment of NOPSI's wholesale rate for Grand Gulf I.

2. The manner in which NOPSI's management maintained oversight and review of its Grand Gulf obligation as the project went forward was uncritical and severely deficient, particularly

during the important 1979-80 time period, which was characterized by NOPSI's management as a "very dynamic time." There were, with respect to Grand Gulf, no established committees within NOPSI, no regular procedures for handling or analyzing information, no meetings on important events, little if any prior consultation with NOPSI's board of directors, and substantially no effort to probe the significance of currently unfolding events and circumstances of great potential importance. At best, NOPSI's management simply remained ignorant of important information and the significance of events that had a dramatic impact on NOPSI's Grand Gulf commitment. At worst, NOPSI's management was caught up in an effort to portray Grand Gulf as a great benefit to ratepayers at a time when it knew the prospect to be otherwise. Its actions fell far short of prudent management.

3. If NOPSI's management had been aware of important new developments in the forecasting of nuclear plant costs, as it should have been, and if it had properly appraised the impact of the Three Mile Island incident in March 1979, NOPSI's management, acting prudently, would have tried to reduce the risk of NOPSI's Grand Gulf commitment by means that were available to it. Instead, it did the opposite. In January 1980, in the wake of Three Mile Island, it committed to a 29.8 percent share of Grand Gulf I, which was then an unfinished nuclear plant—a share that the FERC found to be excessive—and made no effort to reduce its risk exposure. NOPSI could be sure that it would be required to take some portion of Grand Gulf as a matter of system responsibility, and should have sought to limit its risk by selling all or part of its share off-system—as it later told the Council it could do. NOPSI could then have purchased less expensive coal-fired capacity to meet its future needs. NOPSI took no such action or other measures, and such inaction was grossly imprudent under circumstances as they existed in 1979-80.

4. We find that in 1979-80, NOPSI should have sold substantially all of its Grand Gulf share off the system, just as its presi-

dent testified before the Council in September 1980 that NOPSI could do. However, for present purposes, and based on the expert testimony in the record, we are willing to assume that NOPSI might have retained a portion of Grand Gulf I relative to its comparative size within the MSU system—that is, about 9 percent of the system's Grand Gulf I obligation. In other words, NOPSI could have stood by its commitment to take and pay for Grand Gulf I power as required by the System and ultimately determined by the FERC, but should have reduced its risks by making power sales of that portion of its commitment which exceeded a 9 percent share of Grand Gulf. Thus, for the purpose of retail ratemaking, the amount of NOPSI's share of Grand Gulf I above 9 percent should—in the absence of the further considerations discussed below—be passed through as retail rates only at the cost level of coal-fired power, which NOPSI should have obtained as an alternative. On average, this would result in about a 31 percent "effective" reduction in the dollar amount of Grand Gulf I costs that NOPSI could reflect in its retail rates—although, it is important to make clear, this results from an offset to such costs and not from a rejection of the FERC's allocation of them.

5. We have determined, however, that in the circumstances currently facing NOPSI, disallowance of the full amount warranted by NOPSI's imprudence would cause NOPSI to become insolvent and force its bankruptcy. Further, since NOPSI would be unable to pay all expenses associated with its FERC-determined allocation of Grand Gulf I, such a result might be viewed as an attempt to undercut the FERC's allocation, contrary to our stated intention in conducting this proceeding. Based on the evidence advanced in the second phase of the hearings, we believe NOPSI could withstand an imprudence deduction of $150 million on a one-time basis and, as a matter of caution and conservatism, we have reduced that potential disallowance by a ten percent buffer. We therefore conclude that $135 million of costs

attributable to Grand Gulf I should not be recovered in retail rates, this to be implemented as provided herein.

6. As part of our final order in this matter, to assure the feasibility of financing, we shall further specify (a) that there shall be no further deductions for imprudence respecting Grand Gulf I; (b) that NOPSI shall be given timely consideration of rate relief in the future allowing for recovery of its legitimate costs unrelated to Grand Gulf, plus a reasonable rate of return; (c) that NOPSI shall receive prompt consideration of applications for financing necessary to find its operations; and (d) that the Council understands the need for reasonable assurance to debt and equity investors in NOPSI as to the safety of their investments.

7. We emphasize that our findings and conclusions in this matter are without prejudice to any action that may be taken with respect to both the municipalization of electric service in New Orleans and the "abrogation" lawsuit now pending in Louisiana State courts.[3] Moreover, in the event of a new and different wholesale cost allocation by the FERC or a significant change in financial conditions, the Council shall review the determinations made in light of changed circumstances.

III. *PRELIMINARY MATTERS*

A. *Litigation and Procedural Disputes*

Upon acquiring regulatory jurisdiction from the LPSC on May 15, 1985 as previously described, the Council faced the task of establishing the procedural framework within which to execute its regulatory function. However, two days after the Council assumed regulatory authority, and prior to the adoption of filing requirements and procedures, NOPSI filed a retail rate application reflecting its Grand Gulf I costs. The course of proceedings

[3]*City of New Orleans v. New Orleans Public Service, Inc.*, No. 84-4767 (Civ. Dist. Ct. for the Parish of Orleans).

did not run smoothly. After initially proposing a settlement, NOPSI took the position that the Council was required to pass through the full costs of Grand Gulf I immediately, without moderation, and without regard to potential "rate shock" affecting the New Orleans community. It commenced litigation seeking court-ordered rate relief as well as damages from the Council and its members individually. Its litigation efforts were substantially unsuccessful. These events are described below.

After the Council reacquired regulatory authority, it moved promptly to develop filing requirements and other necessary procedures. The Council recognized that NOPSI's application for permanent relief could not be acted upon immediately. Thus, at a public hearing on July 25, 1985, we noted that no formal request for interim rate relief had been filed by NOPSI, and we invited NOPSI to file such a request pending a final rate determination. We offered expedited treatment "in order to prevent any undue hardship" to the company. Council Motion MM-85-326.

NOPSI did not file a request for interim relief but instead, on August 2, 1985, it commenced an action in the United States District Court for the Eastern District of Louisiana seeking declaratory and injunctive relief ordering the immediate pass through of Grand Gulf I costs as retail rates—on the ground that the FERC's ruling as to wholesale rates was determinative as to retail rates. NOPSI also sought one billion dollars in damages against the City of New Orleans, the Council, and its members, personally and individually. *New Orleans Public Service, Inc., v. The City of New Orleans,* Civ. Action No. 85-3398 (E.D. La. Sept. 16, 1985) ("*NOPSI I*"). At a hearing on August 12, 1985, the district court, by oral order, denied NOPSI's motion for preliminary injunction. After the denial of NOPSI's motion, and pursuant to district court order, NOPSI sought interim relief from the Council on August 19, 1985. We acted upon NOPSI's request expeditiously. On September 5, 1985 the Council adopted Resolution R-85-526, which granted NOPSI $28.3 million interim re-

lief, specified that NOPSI could recover, for the period of the Council's deliberations, the amount finally determined to be proper and invited NOPSI to seek further interim relief if necessary. Acting upon the advice of expert consultants, the Council determined that NOPSI, given this relief, could remain in a positive cash position through March 1986.

On September 25, 1985, NOPSI requested certain revisions to and clarifications of the grant of interim relief. The Council conducted a public hearing on this request on October 3, 1985. By Resolution R-85-635, issued October 10, 1985, the Council responded to the matters raised in NOPSI's request and again indicated the Council's willingness to review further the need for interim rate relief if merited by future circumstances.

On September 16, 1985, the district court, upon defendants' motion, dismissed NOPSI's complaint on the basis of the Johnson Act, 28 U.S.C. 1342, and the abstention doctrine. In a written opinion, Judge McNamara noted that "the Council is using every feasible alternative to keep NOPSI in a positive cash position." Slip op. at 11. After the dismissal of its lawsuit, NOPSI made a partial submission of its refiled application on September 30, 1985, two weeks overdue, and completed its submission on October 11, 1985. On October 17, 1985, NOPSI filed a notice of appeal of the district court's order in *NOPSI I* to the Court of Appeals for the Fifth Circuit.

On October 10, 1985, the Council, as part of its retail rate proceedings, adopted Resolution R-85-636 (the "Prudence Resolution") which initiated this investigation of NOPSI's prudence with respect to its purchase of power and energy from the Grand Gulf plant and requested NOPSI to respond to a series of questions related to the investigation within 30 days (by November 18, 1985).

NOPSI did not submit such a response, but instead, NOPSI and its affiliate, MSE (SERI), commenced a second action in

federal district court on November 14, 1985, seeking a temporary restraining order and injunction against the conduct of the prudence investigation—based on substantially the same grounds as were involved in the prior action. *Middle South Energy, Inc. v. The Council of The City of New Orleans*, Civ. Action No. 85-5273 (E.D. La., Dec. 11, 1985) ("*NOPSI II*"). On December 11, 1985, the district court, on motion, dismissed the second action on essentially the same grounds as it had dismissed *NOPSI I*.

Concurrently with the filing of *NOPSI II*, NOPSI filed its brief in its Fifth Circuit appeal of *NOPSI I* and moved for expedited appeal. NOPSI's affiliate, MSE, filed a motion for leave to file an *amicus curiae* brief in the *NOPSI I* appeal.

Following the dismissal of its second lawsuit and approximately one month out of time, NOPSI submitted prepared testimony and exhibits in this proceeding on December 16, 1985, in response to the inquiries set forth in our Prudence Resolution. A week later, NOPSI filed a motion for a new trial in *NOPSI II*.

On February 14, 1986, the Court of Appeals issued an opinion reversing the district court's determination in *NOPSI I*, that it did not have jurisdiction because of the Johnson Act, or should not exercise it because of the abstention doctrine, and the appellate court determined that the case should be remanded for a determination on the merits—as to which it expressed no opinion except to reject certain contentions made by NOPSI.[4] *New Orleans Public Service, Inc. v. The City of New Orleans*, 782 F.2d 1236, 1242 (5th Cir. 1986). The Court of Appeals, however, did

[4]Despite the express requests of NOPSI to decide, as a matter of law, that the Council's regulatory activities were preempted, the Fifth Circuit Court of Appeals specifically declined to do so. The Court noted that (1) NOPSI's claim of preemption was based upon inferential grounds (slip op. at 9); and (2) the cases upon which NOPSI principally relied did not support an immediate pass through of Grand Gulf costs to retail ratepayers. 782 F.2d at 1242.

not issue a mandate with respect to its decision, and therefore jurisdiction in *NOPSI I* was not returned to the district court. On June 10, 1986, the Clerk of the Court of Appeals issued a letter to the parties indicating that the Court was considering withdrawal of that portion of its opinion dealing with the abstention doctrine and affirmance of the district court's decision, and it requested additional briefs from the parties. These were submitted on June 25, 1986.

On September 2, 1986, the Court of Appeals issued a new opinion, 798 F.2d 858 (5th Cir. 1986), in which it withdrew Part IV of the previous opinion dealing with abstention and affirmed the district court's dismissal of the case on abstention grounds. The Court noted in part that, "the regulation and adjustment of local utility rates is of paramount concern and a matter which demands local administrative expertise." (*Id.* at 862.) The Supreme Court denied NOPSI's petition for a writ of certiorari, notwithstanding the submission of a brief by the FERC and the Solicitor General as *amici curiae* in favor of review. 107 S.Ct. 1910 (April 20, 1987).

After the initial decision of the Court of Appeals, NOPSI filed, on February 25, 1986, a motion for summary judgment in *NOPSI II*. This was denied on March 13, 1986. On March 17, 1986, NOPSI filed motions in *NOPSI II* seeking partial summary judgment and/or clarification, expedited review, and certification of certain questions to the Court of Appeals. Through these motions, NOPSI sought to have the district court bar the Council's discovery into a number of areas. (As discussed in the next section, NOPSI had refused to provide certain discovery sought by the Council.) Supplemental briefs were filed on April 1, 1986, at which time the district court took the motions under advisement. However, in a telephone conference between Judge McNamara and the parties shortly before the commencement of the prudence hearings, the Court rejected the rulings requested by NOPSI and indicated that its prior rulings were not to be used by NOPSI as

a basis for its refusal to provide discovery to the Council. (Tr. 1897.) On October 28, 1986, after the Council filed a new motion to dismiss based on the final decision in *NOPSI I*, NOPSI filed a First Supplemental and Amended Complaint. NOPSI no longer sought to bar the Council from conducting a prudence inquiry. Rather, it sought an injunction which would bar the Council "from entering an order . . . as a result of the 'prudence' investigation . . . which would have the effect of 'trapping costs', that is, compelling NOPSI or its shareholders to absorb all or part of the costs allocated to NOPSI" by the FERC. This was an apparent attempt to shield NOPSI in advance from any monetary penalty even if imprudence were found and regardless of the facts developed. On December 19, 1986, the district court dismissed the Amended Complaint on the basis of (1) the abstention doctrine; (2) lack of ripeness; and (3) as to SERI, its lack of standing. That decision was affirmed on the ground of lack of ripeness by the Fifth Circuit on December 11, 1987, 833 F.2d 583 (5th Cir., 1987), and a petition for rehearing was denied in January 1988.

B. *Efforts to Block Discovery*

Throughout the course of the proceedings, NOPSI repeatedly declined to provide information and to comply with the Council's discovery requests promptly and fully.

At the outset of the prudence inquiry, NOPSI put a great premium on speed. Its complaint in *NOPSI II* alleged that the Council's conduct of a prudence inquiry might have the effect of delaying a decision on its rate application. Nevertheless, NOPSI consistently responded late and incompletely to requests for data and document production.

More important is that when NOPSI did respond, it categorically refused to produce relevant materials. As support for its refusal, NOPSI relied primarily upon language from the district

court's decision in *NOPSI II*, having nothing to do with discovery.[5] NOPSI failed, for example, to produce:

- documents relating to any attempt or effort by NOPSI to negotiate arrangements for Grand Gulf other than it had agreed upon (Cain Deposition Request 8, Hurstell Deposition Request 11, McLetchie Deposition Request 11);
- documents constituting or referring to actions that NOPSI might take or has taken with respect to any financial difficulty in connection with the construction or operation of Grand Gulf or NOPSI's obligations with respect to Grand Gulf (Cain Deposition Request 9, Hurstell Deposition Request 12, McLetchie Deposition Request 12);
- documents relating to any nuclear unit other than Grand Gulf I, in response to a request for all documents relating to the actual or potential effect upon ratepayers of Grand Gulf or any nuclear plant in the Middle South System constructed on or after January 1, 1974 (Cain Deposition Request 1, Hurstell Deposition Request 4);
- documents relating to any attempt, effort or suggestion within or by NOPSI or any other MSU operating company (a) to curtail the construction of Grand Gulf 1 or 2; or, (b) to accelerate it (Cain Deposition Request 2, Hurstell Deposition Request 6, McLetchie Deposition Request 5).[6]

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[5]In its decision, the district court stated its view as to what the Council proposed to do in its prudence inquiry and what it proposed not to do. *NOPSI II*, Slip op. at 7-8. NOPSI asserted that this statement barred discovery of numerous matters which it claimed were outside the court's recital. In a telephone conference shortly before commencement of the hearings, the court expressly informed the parties, without addressing the overbreadth of NOPSI's assertions, that its decision was not to be taken to be a bar to discovery at all. (*See* Tr. 1897.)

[6]Similarly, NOPSI erroneously relied upon *American Electric Power Service Corporation*, 32 FERC ¶ 61,363 (1985)—a FERC decision having nothing to do with discovery—as a basis for objecting to other, obviously pertinent, discovery requests. *See* Cain Deposition Request 3;

(Footnote continued on following page)

In addition, NOPSI either refused to produce or provide answers for many of the data requests submitted by the Council's staff and consultants, or provided incomplete responses.[7] Certain documents requested during depositions, and which were otherwise called for (for example, the periodic cost forecasts for Grand Gulf) were never produced at all.

NOPSI categorically refused to allow inquiry into the activities of any other company in the Middle South system, regardless of their relevance to the actions of NOPSI's own management. Nevertheless, throughout these proceedings, NOPSI has relied on a "system" defense. It has argued that the predicament in which it has found itself with respect to Grand Gulf was the result of "system" decisions for which NOPSI cannot be held accountable. When it was in its interest to do so, NOPSI proffered witnesses from other companies to testify as to actions of the "system" and to particular events involving other companies. Moreover, it submitted documents prepared by other MSU companies as well as those found in the files of a sister company.

For example, NOPSI submitted testimony of Regis Trumps, an employee of Middle South Services, Inc., and it proffered the testimony of George White, an employee of MSU, concerning the response by Middle South companies to the Three Mile Island

(Footnote continued from previous page)
McLetchie Deposition Request 6 (requesting all documents related to any analyses by NOPSI on the possibility of obtaining capacity or energy from sources other than Grand Gulf in lieu of capacity or energy from Grand Gulf or any other nuclear plant).

[7]*See e.g.*, Data Request PB-1 (requesting a copy of every major study or analysis, conducted by or for NOPSI, from January 1, 1970 through the present, pertaining to the economics of construction, continued construction, and/or operation of Grand Gulf I); Data Request PB-8 (requesting estimates of the cost to construct Grand Gulf made from the construction of the project through the present); Data Request PB-13 (requesting all estimates prepared by, or on behalf of NOPSI, after 1975, concerning the costs associated with terminating Grand Gulf).

incident.[8] NOPSI also introduced documents from sister companies, such as an LP&L Memorandum re: Allocation of Future Generation Under System Agreement (*see* Response to Data Request PC-5), system documents such as MSU generation planning studies, (*see* Exhibits MLH-8A, MLH-8B, MLH-14), and documents it found in the files of LP&L purporting to bear on the relative economics of coal and nuclear power after the Three Mile Island incident. (Tr. 781.)

Despite its own reliance on "system" testimony and its selective use of materials from other companies, NOPSI blocked the Council's discovery of matters involving the activities of other companies in the system bearing upon matters involving NOPSI's own management.[9]

On this basis, NOPSI's counsel blocked many inquiries into meetings involving Mr. Cain and the officers of other Middle South companies, held as part of the activities of MSE. NOPSI's counsel often instructed witnesses not to answer questions concerning, *e.g.*, discussions of the MSE Board of Directors (CNO

[8]On April 14, 1986, the final day of the evidentiary hearing concerning the prudence phase of this proceeding, NOPSI sought to call George White, Jr., as a witness. No written testimony of Mr. White had previously been submitted and the offer of his testimony was contrary to the rules of practice and procedure adopted by this Council for presentation of evidence. Nonetheless, this Council agreed to accept Mr. White's testimony into the record if NOPSI agreed to comply with several conditions generally aimed at ensuring discovery of matters relevant to Mr. White's testimony. *See* Council Ltr. April 19, 1986. NOPSI refused to comply with such conditions. *See* NOPSI letters dated April 28, 1986 and May 2, 1986.

[9]For example, during the deposition of James Cain, counsel for NOPSI stated:

> Further, I will not permit Mr. Cain to respond to any questions as to any activities, or any conduct of his in any capacity other than as president of NOPSI. . . .

(CNO Exh. 28 at 5.)

Exh. 28 at 17); communications with other operating companies, relating, for example, to the ability of ratepayers to bear the cost of Grand Gulf (*Id.* at 48); and the existence of studies relating to the possibility of cancelling or curtailing the Grand Gulf 1 or 2 projects: (*Id.* at 86.)

Similarly, NOPSI, objecting that the Council's requests inquired into management decisions of NOPSI's parent or sister corporations, refused to respond to such requests as those for:

> documents referring to need or desire of NOPSI for construction or operation of Grand Gulf or such need or desire on the part of any of NOPSI's affiliated operating companies, or the lack of such need in each case.

(*Id.*, Document Request 10, McLetchie Deposition Request 13.)

Only just before the commencement of the actual hearings, when Judge McNamara instructed the parties that discovery was not to be limited as NOPSI contended, did NOPSI produce additional documents, but its production remained deficient. Moreover, by adopting categorically the position that it would not produce documents relating to other Middle South companies, throughout substantially all the discovery period, NOPSI successfully frustrated the efforts of the Council's expert consultants to obtain information. (Tr. 1690-1692.)

The position taken by NOPSI through the discovery phase of the prudence inquiry was wholly at odds with the common understanding of the scope of discovery held by courts and practitioners in virtually all jurisdictions. The scope of discovery is very broad. Inquiries need only be reasonably calculated to lead to evidence that may be used at a trial or hearing.

The fact that a particular substantive decision would not be a part of the Council's considerations—for example, whether NOPSI's ultimate share of Grand Gulf as determined by the FERC was proper—does not preclude or obviate inquiry into the

process by which NOPSI and its sister companies went about deciding upon their original allocations. For one thing, it is indispensible background for an understanding of what happened here. For another, it could produce important insight into the views of NOPSI and its sister companies as to whether Grand Gulf was perceived as a benefit or a burden at critical points in time, when other actions might have been taken.

Similarly, questions about whether consideration was given to cancelling Grand Gulf would shed light upon whether and when the operating companies may have appreciated the growing detriments of Grand Gulf. They would also test the representations made by NOPSI, publicly and before the Council, that Grand Gulf would be a great benefit to New Orleans' ratepayers. These and similar lines of inquiry were blocked by NOPSI's refusal to provide relevant information.

Most disturbing to the Council is the implausible paucity of documents produced by NOPSI relating to Grand Gulf. Despite the fact that this was a project of unprecedented magnitude for which NOPSI had assumed a major commitment, there are few intercompany and nearly no intracompany memoranda produced by NOPSI relating to Grand Gulf. For example, none of the notes or agendas relating to the meetings of the MSE board or of the Middle South Operating Committee ("MSOC"), or among NOPSI personnel, seems to have survived; if they did, they were not produced. As another example, the Three Mile Island incident portended a major impact on nuclear plant costs; but there were no memoranda dealing with the effect, or lack thereof, on the Grand Gulf project, authored by NOPSI personnel or by others in the "system," in NOPSI's files. As another example, the process by which NOPSI ultimately decided to take, or was given, a 29.8 percent share of Grand Gulf I must have been of great importance and concern; yet no NOPSI memoranda were produced relating to it either. Given the usual and expectable prac-

tices of business management, there are serious and unsettling questions generated by the dearth of production of such documents.

C. *Due Process Issues*

NOPSI has asserted that this proceeding is "fraught with arbitrary and capricious actions by the Council expressly calculated to deny NOPSI its right to a fair and complete hearing." (NOPSI Br. at 16.) In view of NOPSI's attempt to disrupt the ratemaking proceedings, to prevent a prudence inquiry, and to block discovery of its managements' actions, its charges of procedural detriment would seem to be diametrically misdirected.

NOPSI's assertions rest principally upon two matters. First, NOPSI argues that the Council failed to allow NOPSI sufficient time within which to prepare its rebuttal case in phase one of the proceedings. Second, it claims that the Council's unwillingness to accept the testimony, offered by NOPSI out-of-time, of a proposed surrebuttal witness—unless NOPSI's first provided discovery relating to the subject matter of his testimony—violated its rights to due process.

By way of background, the Council has, from the outset, been committed to a prompt resolution of NOPSI's retail rate application, as indicated by the expeditious treatment given to its application for interim relief and other matters. During the main part of the rate case NOPSI stressed its interest in a speedy resolution, particularly prior to the settlement that allowed certain increased rates to go into effect. Judge McNamara had also expressed strong interest at that time in the Council's acting promptly.

After settlement of the retail rate proceeding and the grant of rate relief, NOPSI's interest in a speedy resolution of the prudence investigation became less than clear. At times, NOPSI appeared as willing to have the prudence proceeding deferred. At other times it appeared desirous of concluding it promptly. The

Council acted on an expedited schedule to accommodate NOPSI's professed interest in a speedy resolution. All participants in these proceedings were forced to comply with tight time schedules. While NOPSI claims that it had too brief a time within which to prepare its rebuttal testimony, the attorneys for the Council had an even shorter period of time in which to obtain discovery as to this testimony, which included that of two entirely new expert witnesses, as well as new testimony from three other witnesses.

However, the twelve day period for preparation of rebuttal testimony, which NOPSI deems too short, clearly appears to have resulted, at the worst, in inconvenience and certainly not in actual detriment. NOPSI filed detailed and extensive rebuttal testimony, now part of the record. Until NOPSI proffered the testimony of George White at the close of the hearings, there was no occasion on which NOPSI claimed that it had not been able to prepare testimony, and it never pointed to any specific matter as to which it was deprived of an opportunity to develop evidence.

We should add that a right to procedural due process does not include a right to file prepared written rebuttal testimony. Due process requires that a party whose rights are to be adjudicated be given a meaningful opportunity to be heard in a meaningful way. *See Goss v. Lopez*, 419 U.S. 565, 581 (1975). NOPSI was clearly given an opportunity to present its position as part of its direct and rebuttal cases, to present and rebut evidence, to depose and cross-examine witnesses testifying on behalf of the Council, and to participate in a full and fair hearing.

NOPSI also claims that it experienced "difficulty in obtaining a fair hearing" in connection with its attempt to call two surrebuttal witnesses on the last of the hearing. One was Regis Trumps, who had submitted two volumes of direct and rebuttal prepared testimony, as well as oral testimony at the hearing. The matters as to which he was to testify as a surrebuttal witness were

cumulative. (*See* Tr. 1881-82, 1889.) NOPSI's offer of Mr. Trumps was properly rejected by the Hearing Examiner. (Tr. 1886.)

The other proposed witness was George White, Jr., an employee of Middle South Utilities, Inc. He was offered to testify on surrebuttal as to certain matters concerning the response of MSU and the "system" to the Three Mile Island incident, certain information said to have been given to the board of directors of MSE and related matters. Subsequently, the Council received from NOPSI's attorneys, pursuant to their letter dated April 16, 1986, a volume entitled "Proffered Testimony of George White, Jr."[10] No written testimony of Mr. White had previously been submitted by NOPSI, and the offer of his testimony was well out of time and otherwise contrary to the rules and procedures adopted for the conduct of the hearings, as was conceded by NOPSI's counsel. (Tr. 1901.) While NOPSI claimed that Mr. White's testimony would address matters first raised by the Counsel's witnesses during the hearing, this was not so. The matter involved—the utility's response to the Three Mile Island incident—had been put in issue since at least December, 1985 during the deposition of Mr. Cain (*see, e.g.*, CNO Exh. 28 at 71-76) and in January 1986 during the deposition of Mr. Hurstell (*see, e.g.*, CNO Exh. 29 at 665-686).

Instead, NOPSI's offer of Mr. White's testimony brought into sharp focus NOPSI's strategy, highly prejudicial to the Council, of refusing to allow discovery as to important matters involving other Middle South companies, while, at the same time, offering such material and related witnesses when to do so suited NOPSI's purposes. (*See* Tr. 1981-1900 [*sic*].) Although the Council would have been justified in refusing NOPSI's offer outright, instead, by a letter dated April 22, 1986, we granted NOPSI's request to pro-

[10]If Mr. White's formal testimony had been in substance as set forth in the document mentioned in text, it would have denigrated the impact of the Three Mile Island incident on the basis of selective treatment of certain technical issues.

vide an additional hearing date to hear the testimony of Mr. White, on the condition that it provide documentary discovery, to be followed by discovery by oral examination, of matters pertinent to the subject matter of such testimony.[11]

NOPSI rejected that proposal and, by letter dated April 28, 1986, insisted that the prepared text of Mr. White's proffered testimony be accepted "as evidence," without any discovery relating to its subject matter, or apparently any cross-examination. Moreover, NOPSI claimed that the reason that Mr. White's testimony had not earlier been offered was that "it had too little time in which to prepare its rebuttal testimony." The record shows that there is no substance in this assertion. NOPSI's offer of Mr. White came about because the Hearing Examiner had properly rejected NOPSI's offer of certain self-serving material in the 1979 Annual Report of MSU (NOPSI Exh. 42) as substantive evidence of the "system's" response to the Three Mile Island incident—an area as to which NOPSI had refused to provide discovery. Thereafter, on the last hearing day, April 14, NOPSI's counsel first offered Mr. White as a witness, giving as the reason the desire to satisfy the evidentiary objections to said NOPSI Exhibit 42. At no prior time did NOPSI suggest to the Council or the hearing officer that it wanted to call Mr. White as a witness, but had inadequate time in which to prepare his testimony. The Council, by letter dated April 30, 1986, responded to NOPSI's refusal to provide discovery and its demand that the written testimony of Mr. White be accepted "as evidence," stating in part,

> "We categorically reject the idea that NOPSI may enjoy the special privilege of offering witnesses and preparing subject matters for introduction into evidence without giving an opportunity to test their truth and significance through discovery and examination."

[11]The Council also made it a condition that the Council's attorneys have the right to present rebuttal testimony if desired, and that NOPSI make available witnesses to authenticate two documents emanating from companies in the Middle South system.

Such determination is hereby reaffirmed, and the "due process" objections of NOPSI are rejected as without substance.[12]

IV. *LEGAL STANDARDS IN THESE PROCEEDINGS*

A. *The Purpose of and the Standards Governing This Prudence Investigation*

Our inquiry into the prudence of NOPSI's conduct at the retail level with respect to Grand Gulf is based upon the longstanding principle that costs may be passed onto ratepayers only to the extent that they have been prudently incurred. *See Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U.S. 276 (1923). The contemporary role of the prudence doctrine has been described as follows:[13]

> The concept of a prudent investment in public utility law is a regulatory oversight standard that attempts to serve as a legal basis for judging whether utilities meet their public interest obligations. . . .
>
> • • •
>
> . . . State commissioners today are pulled between the obligation to keep utilities financially sound and able to provide reliable service to customers and the obligation to set rates at a level reasonably related to the costs of providing service. They have been forced to choose between these two obligations where large investment values are at stake and where commission action exposes either stockholders or ratepayers to severe financial losses. The concept of prudence provides commissions with a principle that does not necessarily require an "all or nothing" decision in favor of one side, but can allow some sharing of the risks between investors and ratepayers. The prudent investment test is a tool that regulators are using to provide an answer to the question of who should bear which risks and associated costs.

[12]Copies of the foregoing correspondence shall be considered part of the record of this proceeding.

[13]Burns, Poling, Whitman and Kelly, *The Prudent Investment Test in the 1980's*. The National Regulatory Research Institute, 1985, pp. iv. vi.

In the last several years, the construction of nuclear generating plants has given occasion for the conduct of prudence investigations, which have, in notable cases, resulted in substantial cost disallowances. For example:

- The New York Public Service Commission, after investigating the prudence of LILCO's management and construction of the Shoreham Nuclear Plant, disallowed $1.395 billion of the $4.5 billion costs of Shoreham.[14]
- The Missouri Public Service Commission, after investigating Union Electric's prudence with respect to the 84% share of the Callaway plant within its jurisdiction, disallowed $384 million of the $2.5 billion in Callaway costs for which Union Electric had sought recovery.[15]
- The Missouri Public Service Commission, finding, *inter alia*, that a significant portion of the cost overruns at the Wolf Creek nuclear plant resulted from unreasonable or unexplained cost increases and inefficient or imprudent management of the project, disallowed approximately $126 million (14%) of Kansas City Power & Light Company's portion of the plant under Missouri jurisdiction.[16]

[14]Case 27563 (*Long Island Lighting Company—Phase II—Proceeding on Motion of the Commission to Investigate the Cost of Construction of the Shoreham Nuclear Generating Facility*) Opinion No. 85-23 (issued Dec. 16, 1985) ("*Shoreham*").

[15]*In the Matter of the Determination of In-Service Criteria for the Union Electric Company's Callaway Nuclear Plant and Callaway Rate Case and Related Issues*, Case No. EO-85-17 (MoPSC March 1985) ("*Callaway*").

[16]*In the Matter of Kansas City Power & Light Company of Kansas City, Missouri, for Authority to File Tariffs Increasing Rates for Electrical Service Provided to Customers in the Missouri Service Area of the Company, and the Determination of In-Service Criteria for Kansas City Power & Light's Wolf Creek Generating Station and Wolf Creek Rate Base and Related issues*, Case No. EO-85-185 (MoPSC, April 23, 1986).

- The Michigan Public Service Commission, based primarily on the imprudent delay in the plant's completion, disallowed $122.9 million of the $1.925 billion Detroit Edison spent on its Belle River coal plant.[17]

- The Maine Public Utilities Commission, after investigating the prudence of the investments of Maine utilities in the Seabrook nuclear power project, entered into a rate case settlement with Central Maine Power Co. whereby Central Maine Power Co. agreed that 40%, or $14.8 million, of its Seabrook-2 construction costs would not be recovered, as well as 30%, or $63.9 million of the Seabrook-1 construction expenses incurred before January 1, 1985.[18]

- The Public Utilities Commission of Ohio recently disallowed for ratemaking purposes $627.8 million of the cost of building the $5.5 billion Perry nuclear power plant owned by Centerior Energy Corp., Ohio Edison Co., and Duquense Light Co. as imprudently or unreasonably incurred.[19]

A prudence review is an appropriate function of the ratemaking authority and has been undertaken where, as here, the utility's actions have resulted in extraordinary costs that raise the clear prospect of actual harm to the ratepaying community and are clearly out of line with competing sources of generation.

1. *Standard of Prudence*

The standard of prudence to be applied in reviewing the evidence is not in serious dispute. Experts testifying on both sides of

[17]*In the Matter of the Application of Detroit Edison Company for Authority to Amend Its Rate Schedules Governing the Supply of Electric Energy and Amend Other Miscellaneous Rates*, Case No. U-7660 (MoPSC, July 16, 1985).

[18]*Central Maine Power Co.*, Case 84-120, Order and Stipulation, (MePUC May 30, 1985).

[19]*Wall Street Journal*, Jan. 13, 1988, p. 36.

this case have agreed that the standard should be that of "reasonableness under the circumstances."[20] NOPSI stated the standard of prudence to be:

> whether the utility followed a course of conduct that a capably managed utility would have followed in light of existing and reasonably knowable circumstances.

In re Seabrook Involvements by Maine Util., 67 P.U.R. 4th 161, 166 (Maine 1985) ("Seabrook"). NOPSI Memo Re Item VII at 3-4. Augmenting this formulation, we believe the standard should be:

> The Company's conduct should be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the Company had to solve its problems prospectively rather than in reliance on hindsight. In effect, our responsibility is to determine how reasonable, competent management would have performed given the circumstances that confronted the company.

In substance, this standard has been applied in prudence investigations by the New York Public Service Commission,[21] the Missouri Public Service Commission,[22] the Washington Utilities and Transportation Committee,[23] and the Massachusetts Department

[20](*See* NOPSI Br. at 19; CNO Exh. 31 at 5;) Memorandum Submitted By NOPSI in Response to Item VII of City Council Resolution R-85-636, at 3-4 (December 16, 1985) ("NOPSI Memo Re Item VII"); (NOPSI Exh. 46 at 3) (December 13, 1985).

[21]*Shoreham*, Slip op. at 9.

[22]*Callaway*, Slip op. at 12.

[23]*See Washington Utilities and Transportation Committee v. Puget Sound Power & Light*, 62 P.U.R. 4th 557, 584 (WUTC 1984) (the following test was applied to measure prudence: what would a reasonable board of directors and company management have decided given what they knew or reasonably should have known to be true at the time they made a decision.)

of Public Utilities.[24] In addition, the Federal Energy Regulatory Commission ("FERC") has adopted the same standard of prudence.[25]

NOPSI has asserted[26] that the following "well accepted guidelines" must be followed in applying the reasonableness standard of prudence:

> 1. there should exist a rebuttable presumption that the questioned decision of the utility is prudent;
>
> 2. a utility decision should be judged under the circumstances that were known or should reasonably have been known when the decision was made;
>
> 3. hindsight should not be used in determining prudence; and,
>
> 4. prudence should be determined in a retrospective, factual inquiry—looking to the circumstances when the decision was made.

[24]*See also Fitchburg Gas & Electric Light Company,* D.P.U. 84-145-A (Mass. 1985) and *Boston Edison Company,* D.P.U. 906 (Mass. 1981) (prudence is defined as the utility management's having made a reasonable decision based on what it knew or should have known at the time of the decision.)

[25]*See New England Power Company,* 31 FERC ¶ 61,047 at 61,084 (1985) where the FERC stated:

> In performing our duty to determine the prudence of specific costs, the appropriate test to be used is whether they are costs which a reasonable utility management (or that of another jurisdictional entity) would have made, in good faith, under the same circumstances, and at the relevant point in time. We note that while in hindsight it may be clear that a management decision was wrong, our task is to review the prudence of the utility's actions and the costs resulting therefrom based on the particular circumstances existing either at the time the challenged costs were actually incurred, or the time the utility became committed to incur those expenses.

[26]*See* NOPSI Memo Re Item VII (at p. 3-4).

We believe that these guidelines are embodied in the standard of prudence we have adopted, and we therefore have followed such guidelines in reaching our decision. (We discuss below the circumstances under which the presumption of prudence may be rebutted.) In addition, in general accord with other local regulators,[27] we have also considered the following factors in our determination of NOPSI's prudence:

- Senior utility executives are expected to possess a high degree of management expertise, and where their position so requires, financial and technical expertise as well.
- While the prevailing practice of the utility industry is relevant, it is not determinative, since the practice may be the result of self-interest and may not be prudent in respect to the obligations that the utility is bound to fulfill. Industry norms may be an indication of whether the company's responses to its problems were reasonable at the time. The decisions of utility executives must also be reasonable when viewed against the decisions and conduct of other corporations that make investment decisions of a comparable size and complexity and other relevant facts.
- The size and nature of the project being reviewed must be considered. Thus, greater care should be exercised where the magnitude of the investment is in the hundreds of millions or billions of dollars than when lesser businesses or responsibilities are involved.
- Prudent management requires an ongoing review of project expenditures, an obligation to seek out relevant information and continuing action in response to changing circumstances.
- Management has an obligation to comply with legal requirements, including its obligation as a utility to provide reliable electric service at economic rates.

[27]Both the New York Public Service Commission in *Shoreham* and the Maine Public Utilities Commission in *Seabrook* considered these factors in their respective prudence inquiries. *See Shoreham* Slip op. at 12, 14; *Seabrook* at 166-167.

Finally, we note NOPSI's statement that then Councilman Barthelemy articulated the "correct standard to be applied in this matter" when he stated, in an affidavit, that the Council has an obligation to ensure that NOPSI's rate payers are not forced to bear costs "incurred imprudently by the utility as a result of mismanagement or gross neglect ...." Affidavit of S. J. Barthelemy, *Middle South Energy, Inc. v. The Council of the City of New Orleans,* at 3, Civil Action No. 85-5273 (E.D. La. Dec. 5, 1985). We view the term "mismanagement" as synonymous with the failure to act reasonably under the circumstances, for example, by a marked failure to meet one or more of the relevant factors noted above. While costs resulting from "gross neglect" by utility management certainly should not be passed on to ratepayers, a finding of imprudence is not, of course, dependent upon a finding of gross neglect. Ratepayers are entitled by law to a higher standard of performance by utility management than the mere avoidance of gross neglect.

2. *Burden of Proof*

In a normal rate case, the utility must prove that its rates are just, reasonable nondiscriminatory [*sic*]. There is some dispute as to whether a utility bears the burden of proving, in its case-in-chief, that all decisions and expenditures were prudent.[28] Here, we will follow the FERC's position that there is a rebuttable

[28]A presumption of prudence has been generally upheld by the FERC and apparently is derived from Justice Brandeis' concurrence in *State of Missouri ex rel. Southwestern Bell Telephone Co.*, 262 U.S. 276, 289 (1923) wherein he stated:

> Every investment may be assumed to have been made in the exercise of reasonable judgment unless the contrary is shown.

However, in *Shoreham* the New York Public Service Commission, noting that the Public Service Law imposes on the utility the burden of proof in a rate proceeding, stated that the company bears that burden in a prudence inquiry as well, where the regulatory body is attempting to identify the costs that may properly be included in rates. *Shoreham* at 6.

presumption that the company's decisions and expenditures were prudent.[29] Thus, when NOPSI filed its request for Grand Gulf related rate relief, there existed a presumption that NOPSI's Grand Gulf related decisions and expenditures were prudent.

This presumption of prudence may, however, be rebutted and the burden of proof returned to the proponent of the rate increase. According to the FERC, "where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent." *Minnesota Power & Light Company,* 11 FERC ¶ 61,312, 61,645 (1980). "A 'doubt' is created if the challenge raises a question, the answer to which, is not unarguably in favor of prudence. Moreover, a doubt is 'serious' if there appears at least a possibility that, upon due investigation, the answer to the question will lead to a finding against prudence." *New England Power Company*, 27 FERC ¶ 63,037, 65,157 (Nacy A.L.J. 1984) *rev'd on other grounds*, 31 FERC ¶ 61,047 (1985).

Even before the introduction of testimony by attorneys for the Council, the facts and circumstances surrounding NOPSI's involvement in Grand Gulf, apparent at the time the Council initiated this prudence investigation by adopting Resolution No. R-85-636, created serious doubt as to whether NOPSI's conduct was prudent. Specifically, Resolution No. R-85-636 noted, *inter alia,* that:

- NOPSI entered into a series of open-ended agreements whereby it guaranteed the indebtedness of MSE for construction of Grand Gulf and assumed responsibility for Grand Gulf capacity and power, without restrictions on the ultimate cost of the plant and without limits on NOPSI's cost responsibility;

[29]*See New England Power Co.*, 31 FERC ¶ 61,047, 61,081-61,082 (1985); *Commonwealth Edison Company*, 27 FERC ¶ 63,072, 65,269 (1984).

- At a time when the cost of Grand Gulf already had greatly exceeded prior cost estimates, NOPSI agreed to a very large share—subsequently determined to have been excessive by the FERC—and to relieve AP&L of its share;
- NOPSI failed to diversify its fuel sources and relied heavily upon a single nuclear power project to satisfy its projected energy needs; and
- Despite escalating Grand Gulf cost overruns and despite NOPSI's assurance to the Council that the Company could sell Grand Gulf power to other entities, NOPSI made no apparent attempt to reduce its risks.

In addition, the enormity of the cost overruns experienced in the construction of Grand Gulf and the potentially disastrous impact these posed for the ratepaying public raised a serious issue regarding the prudence of NOPSI's planning and management conduct. In October 1975, Grand Gulf I was projected to cost $875 million and to be completed by January 1980. The plant actually entered commercial operation in July 1985 at a cost of $3.3 billion for MSE's 90 percent share. The Missouri Public Service Commission, in its investigation of the prudence of the Callaway Nuclear Plant, stated that "the existence of $2 billion in cost overruns raises doubts as to prudence in this case."[30]

However, the foregoing circumstances do not stand alone. There was direct expert testimony in this case that NOPSI had acted imprudently. The testimony of NOPSI's own witnesses established that NOPSI failed to develop any internal organization to deal with its responsibility to maintain oversight of its Grand Gulf obligations, failed even to hold meetings on important issues, failed to examine critically information being received as to costs, failed to obtain necessary information, failed to keep abreast of available analytical techniques, failed to explore alternatives, did not even know what its rights were within the Middle South System, and ultimately accepted, and did nothing to reduce the risks of, a large fixed share of an unfinished nuclear plant that

[30]*Callaway*, Slip op. at 12.

the FERC, prior to the commencement of this proceeding, found to be approximately *70 percent higher* than the share that would have been fair. These circumstances create, by any standard, grave doubts as to whether NOPSI's management engaged in prudent conduct, and such management certainly should bear the burden of proving that it did so.

On most issues, however, allocation of the burden of proof does not play a determinative role. Both sides came forward with evidence on the matters in issue. The findings made herein principally reflect both undisputed facts and the clear weight of the evidence, and rarely rely upon NOPSI's bearing the burden of proof.

B. *Federal Preemption*

The remaining legal issue to be addressed is that of federal preemption. Throughout this prudence investigation, NOPSI has challenged, on the grounds of federal preemption, the Council's authority to conduct a prudence investigation into NOPSI's involvement in Grand Gulf. The central thesis of NOPSI's argument is that the FERC, in Opinion Nos. 234 and 234-A, allocated the costs and power of Grand Gulf I, thereby determining such Grand Gulf costs to be just and reasonable. Hence, it argues, inquiry into NOPSI's prudence, with the potential for the disallowance of a portion of the costs of Grand Gulf, would "frustrate" or "stand as an obstacle" to the Federal Power Act and Opinion Nos. 234 and 234-A. In addition, NOPSI has argued that our investigation impermissibly interferes with interstate commerce.

We note at the outset that neither the purpose nor the effect of this prudence investigation is to interfere with interstate commerce. NOPSI had argued that the effect of any rate disallowance in this proceeding would be to shift costs to other states in violation of the commerce clause of the U.S. Constitution.

Without expressing our view as to whether a shifting of costs, even for legitimate reasons, would be constitutionally permissible,

it is clear here that there is no impermissible burden on interstate commerce. Prior to the conclusion of the rate case here, every other operating company on the Middle South System had entered into a settlement with its respective regulatory authority that involved rate "phase-ins" (that is, the costs of Grand Gulf I would not be fully passed through as incurred, but at later dates) and, in the case of the two largest operating companies, permanent "absorptions" (that is, a portion of the costs would never be passed through to ratepayers).[31]

[31]The settlement between AP&L and the Arkansas Public Service Commission requires AP&L to forego recovery of approximately 20 percent of its Grand Gulf costs and states:

> The proportionate reductions in revenues from AP&L's Arkansas retail customers under this paragraph will be permanent and will never be recovered from AP&L's Arkansas retail customers (except to the limited extent provided elsewhere in the settlement).

AP&L also agreed to defer recovery of large portions of its remaining Grand Gulf costs (41 percent in the first year) for collection after the year 1995. *Arkansas Power and Light Company*, Docket No. 84-249-U, Order No. 26 (APSC, Sept. 9, 1985).

The Mississippi Public Service Commission on September 16, 1985 issued an order deferring recovery of approximately one-third of MP&L's share of Grand Gulf I from its retail customers for the ten-year period 1985-1995. Remaining amounts were ordered to be phased-in over a three year period starting in 1985. *Mississippi Power and Light Co.*, Docket No. U-4620, (MPSC, Sept. 16, 1985) (Slip op. at 3). The MPSC order was issued subsequent to the completion of an investigation into the costs of, and MP&L's "performance" in relation to, Grand Gulf. Decision Management Company, Inc., *Grand Gulf Construction Audit*, April, 1985. (CNO Exh. 29, MLH—19A & B).

On October 15 and 16, 1985, the LPSC held hearings on the adequacy of a report it had commissioned in 1983 concerning, *inter alia*, the prudence of LP&L in regard to Grand Gulf. Decision Management Company, Inc., *A Report on Waterford 3/Grand Gulf Study*, January, 1984. The LPSC announced its intention to conduct an expanded prudence review. However, on November 19, 1985, LP&L and the LPSC reached a settlement whereby LP&L agreed to absorb 18 percent of its Grand Gulf I costs. *Louisiana Public Service Co.*, Order No. U-16945 (LPSC, Nov. 14, 1985).

It was not suggested by NOPSI that the result of these phase-ins and absorptions would be to "shift" burdens to the ratepayers of New Orleans. Moreover, the testimony of NOPSI's own president here established that rate absorption in one jurisdiction did not shift costs to those in other jurisdictions or otherwise have impermissible adverse interstate effects. (CNO Exh. 28 at 125-131.)

Turning to the requirement that the Council recognize the FERC's establishment of a wholesale rate, it should be noted at the outset that in our Prudence Resolution, we expressly stated that "[t]he Council will not seek to invalidate any of the agreements surrounding Grand Gulf I or to order NOPSI to pay MSE a rate other than that approved by the FERC." *See* Resolution R-85-636 at 4. Our purpose is, instead, to review the prudence of the management of NOPSI—a utility operating under a franchise granted by this City—as to the actions it took and could have taken, so as to ensure that only prudently incurred costs are passed on to New Orleans' consumers in their local electric rates.

The issue before the FERC was that of establishing a "method of allocation"—that is a "formula" for the sharing of the power generation costs of Grand Gulf I among the four Middle South operating companies. Ultimately, all the Middle South operating companies, as well as other parties, became involved in an interstate dispute as to what formula should be used to determine individual company responsibility for Grand Gulf I costs as wholesale power rates.[32] In Opinion Nos. 234 and 234-A, the FERC chose a formula that allocated the investment costs of all nuclear, but not other, facilities according to each company's demand. 31 FERC ¶ 61,305 at 61,655. Wholesale rates—representing the formula-generated share of the aggregate of Grand Gulf costs—were set for each of the operating companies. (The

[32]*See Middle South Energy, Inc.*, 26 FERC ¶ 63,044 at 65,097, 65,104 (1984) (Initial Decision); 31 FERC ¶ 61,305 at 61,634, 61,635 (Opinion No. 234).

FERC's substantive allocation, as previously indicated, was reversed and remanded by the Court of Appeals for the District of Columbia Circuit, and thereafter was reaffirmed by the FERC.)

The FERC did not purport to assert jurisdiction over the retail rates to be charged by the operating companies to their local customers, did not presume to preempt the function of the state retail regulatory bodies, did not deal with the problem of "rate shock", did not address the timing or manner in which, or extent to which, the operating companies may recover Grand Gulf-related costs from their customers, did not examine the alternatives available to a company to reduce the risks of its Grand Gulf cost responsibility, and did not examine the prudence of NOPSI's activities, or those of any other operating company, with respect to Grand Gulf.

At the Grand Gulf cost allocation hearings at the FERC, Presiding Judge refused to be drawn into making indirect or implied rulings on prudence:

> MR. MERRIMAN:
>
> * * *
>
> Now, Middle South Energy is exclusively subject to the jurisdiction of the FERC. It is a 100 percent wholesaler. We don't want somebody later someplace to say that therefore the costs involved in that construction were somehow unjust and unreasonable because you did something wrong.
>
> PRESIDING JUDGE: Okay.
>
> But I can't preclude parties here from somewhere else raising anything they want to raise. And the only thing that I'm concerned about is what matters I should decide. And the only thing that I'm concerned about is what matters I should decide. [*sic*] And as far as I can see I don't have to decide the issue of the prudence of the construction—of the decision to construct the Grand Gulf project.

Middle South Energy, Inc., Docket No. ER82-616-000, Transcript of Proceedings, March 14, 1983, at 235-36.

The Presiding Judge was clear that the prudence of the individual MSU companies as *purchasers* of Grand Gulf power should not be a part of his determination:

> MR. O'SULLIVAN: I just wanted to make sure that there was no confusion between the prudence inquiries that I understand you ruled this morning *the states were entitled to make.*
>
> That is, *the prudence of the affiliates* under the jurisdiction of the states making a purchase of Grand Gulf power for purposes of retail resale, and that that issue is not stipulated, the buyers is not stipulated to.
>
> PRESIDING JUDGE: *I'm not getting into that* I don't think in this case.
>
> MR. MERRIMAN: He's not saying one way or the other what the jurisdiction of the state commissions are.
>
> PRESIDING JUDGE: *I'm not getting into that.*

Id. at 228 (Emphasis added.)

At the close of the relevant dialogue, the Presiding Judge said to Mr. Merriman:

> PRESIDING JUDGE: *I don't think you can put me in a position or this Commission in a position of deciding a prudency issue on the allocation issue in such a way that no one can possibly raise this in the State Court.* I think that's the problem you have. I may be wrong.
>
> I don't intend to get into state jurisdiction, but I do intend to get into what a fair and just and reasonable and non-discriminatory rate schedule and agreement is.
>
> MR. EASTLAND: *Wholesale* level.
>
> PRESIDING JUDGE: At the *wholesale* level.

Id. at 248. (Emphasis added.)

In its Opinion Nos. 234 and 234-A, the FERC acknowledged the traditional role of the states in retail ratemaking regulation:

> [W]e concurred in [Judge Head's] discussion of the need to balance Federal and states interests in exercising our juris-

> diction. Furthermore, we think our opinion, taken as a whole, as well as Judge Head's discussion, which we adopted, clearly recognize the role of the states in regulating the retail electric rates and the need to balance overlapping state and Federal electric rate jurisdiction.

Middle South Energy, Inc., 31 FERC ¶ 61,305 (1985) at p. 61,951. The FERC concluded:

> The basic nature of regulatory control retained by the states under previous System agreements remains unchanged. What our decision attempts to do is amend the filed agreements to achieve a non-discriminatory sharing of excess capacity cost imbalances on the integrated System, consisted [*sic*] with the goal of the System Agreement, and to do so with as little intrusion on the States as possible.

Id. at p. 61,952.

In March 1986, the FERC's acting Chairman Sousa, testifying before Congress on behalf of the FERC, stated as follows:

> The Commission did not determine the prudence of the purchase of power by the Middle South Utilities from the Grand Gulf Nuclear Generating Station in Opinion Nos. 234 and 234-A.
>
> At issue in Opinion Nos. 234 and 234-A were the narrower questions of whether the proposed Middle South System Agreement and Grand Gulf Unit Power Sales Agreement allocated the costs of generation and transmission on the Middle South system among its members in a manner that was just, reasonable, not unduly discriminatory or preferential. The proceeding was not one in which the operating utilities attempted to pass through the actual costs associated with the Grand Gulf plant as purchased power expenses in rates charged to their customers.[33]

In contrast to the FERC proceedings, this prudence investigation addresses questions that arise at the retail ratemaking level,

[33]Prepared Testimony of the FERC Before Subcommittee on Energy, Conservation and Power, of the House of Representatives Committee on Energy and Commerce, Hearings on Prudence Review (March 1986) Question 11.

and particularly whether NOPSI's management acted prudently with respect to its Grand Gulf participation and the alternatives available to NOPSI's management in this regard. Were we to adopt a different allocation formula as the basis for retail rates than that adopted by the FERC for wholesale rates, such an action would certainly be in derogation of the FERC's authority and violate the Supremacy Clause of the Constitution. *Nantahala Power & Light Co. v. Thornburg*, 106 S. Ct. 2349 (1986). But we do not do so. The inquiry here falls within the area reserved by *Nantahala—i.e.*, whether there were alternatives by which NOPSI could have curtailed its costs and risks with respect to Grand Gulf. Moreover, there was no independent issue of the prudence of management in the *Nantahala* case as, in contrast, there is here.

The investigation of management's prudence in connection with the setting of retail rates is, as recognized by Congress in the Federal Power Act, by the FERC and by the courts, within the jurisdiction of local regulatory entitles.[34] The FERC has noted that local regulators retain jurisdiction to review the prudence, from the standpoint of the purchasing utility, of wholesale transactions approved by FERC. In *Southern Company Services, Inc.*, 26 FERC ¶ 61,360 (1984), the FERC stated:

> [T]he question of the prudence of a utility's power purchases is properly an issue in the buying utility's rate case where it seeks to pass the cost of its purchased power on to its ratepayers.

26 FERC at 61,795. *See also Pennsylvania Power & Light Co.*, 23 FERC ¶ 61,005 (1983); *Philadelphia Electric Co.*, 15 FERC ¶ 61,264 (1981).

[34]*See Appeal of Sinclair Machine Products, Inc.*, 498 A.2d 696 (N.H. 1985); *Cambridge Electric Light Co.*, Docket No. 84-2B-2 (Mass. D.P.U. May 10, 1984), *appeal docketed*, No. 84-161 (Sup. Ct. Mass., filed May 24, 1984) (Stipulation of Dismissal, Nov. 21, 1985). *Pike County Light & Power Co. v. Pennsylvania Public Utility Commission*, 77 Pa. Commw. 268, 465 A.2d 735 (1983).

Similarly, judicial review of NOPSI's challenges has reaffirmed our authority to conduct this prudence investigation. In dismissing, on jurisdictional grounds, NOPSI's challenge to this Council's prudence investigation in *NOPSI II*, Judge McNamara stated:

> The issue which is involved here pertains to whether or not NOPSI, one of the utility companies that is required to purchase certain power from Grand Gulf as prescribed by the FERC, may be ultimately required to absorb a portion of that cost *if* a prudence investigation by the regulatory authority reflects that the management of NOPSI, *not* the management of the parent or sister corporations, acted imprudently in taking or failing to take certain actions. It is important to note that the FERC opinions are devoid of any proscriptions against local regulatory authority undertaking prudence inquiries. . . . In sum, after reviewing the FERC's opinions and the Council's Resolution, this court has concluded that the Council's prudence investigation does not breach any duty imposed by the FERC's opinions nor does it violate any of their provisions.[35]

Similarly, in addressing NOPSI's contention that the Council's prudence investigation impermissibly interfered with interstate commerce, the court observed:

> No matter what the Council ultimately decides after investigating NOPSI's prudence, the fact remains that NOPSI will still be required to pay its 17 percent allocation as mandated by the FERC. The only question will be whether the cost of that allocation will come entirely from the ratepayer or whether it will be borne in part by the ownership of NOPSI. Consequently, the Council's prudence inquiry has no, and implicates no, interference with interstate commerce.[36]

On the appeal of *NOPSI I*, the Court of Appeals, despite express requests of NOPSI to do so, specifically declined to hold that the Council's regulatory activities were preempted. Rather,

[35]*Middle South Energy, Inc. v. The Council of the City of New Orleans*, Civ. Action No. 85-5273 (E.D. La. Dec. 11, 1985), ("NOPSI II"), slip op. at 7.

[36]*NOPSI II* at 8.

the court noted that the cases upon which NOPSI principally relied did not support any immediate pass through of costs to retail ratepayers:

> However, we do not decide, as NOPSI contends we must, whether NOPSI will prevail in its preemption claim. Achieving federal jurisdiction does not guarantee success on the merits of a claim. *See Montana-Dakota*, 341 U.S. at 249. We therefore do not determine whether the Council must immediately pass through NOPSI's costs. Indeed, the *Narragansett* case, on which NOPSI so heavily relies, did not itself require immediate pass through of costs to retail ratepayers . . . .[37]

The Fifth Circuit also refused to adopt any of the FERC's contentions, submitted as *amicus curiae* in *NOPSI I* (but not stated in Opinions 234 or 234-A) that it had preempted state ratemaking functions as a matter of law.

In *NOPSI II*, the Fifth Circuit again made clear that the *Nantahala* case left retail-level considerations open for state action. 833 F.2d at 586.

In light of the facts developed during this investigation, which form the basis for our decision here, we think that our authority to act has not been, and could not properly be, preempted by the FERC, given the dual regulatory authority established by Congress in the Federal Power Act. *See* 798 F.2d 860.

PART B. DETAILED PRUDENCE ANALYSIS

V. *STATEMENT OF FACTS*

A. *The Middle South System*

1. *Overview*[38]

NOPSI is a wholly-owned subsidiary of MSU and provides electric service within the municipal boundaries of the City of

[37]*NOPSI I*, 782 F.2d at 1242.

[38]Certain names and terms have been previously defined or abbreviated at pages 3-5 *supra*.

New Orleans pursuant to its franchise with the City. NOPSI is a member of the "Middle South System," which includes, *inter alia*, four electric operating company subsidiaries of MSU—NOPSI, AP&L, LP&L and MP&L—as well as MSE (now SERI), MSU's wholly-owned generation company and owner of a 90% interest in the Grand Gulf plant; Middle South Services, Inc. ("MSS"), a service company; and other direct and indirect subsidiaries of MSU. (NOPSI Exh. 35, pp. 2-3.) Service is provided by LP&L to a large part of Louisiana and to the 15th Ward of New Orleans (Algiers); by MP&L to a large part of Mississippi; and by AP&L to parts of Arkansas and southeastern Missouri.

The Middle South System operates as an electric power pool, in which the high voltage transmission facilities of the individual operating companies are interconnected. (NOPSI Exh. 39 at 4.) The power pool is an integrated electric system and serves a 92,000 square mile area covering the four states mentioned above. (*Id.*, p. 3.)

With the recent exception of Grand Gulf, all generation facilities on the system have been built, owned and operated by individual operating companies. (NOPSI Exh. 35 at 5; NOPSI Exh. 39 at 3.) Many of these plants have been certified by the Council or state regulatory commissions and, for retail ratemaking purposes, each is considered as within the rate base of the operating company that owns it. All of the generating units, including Grand Gulf, are centrally-dispatched and controlled by the Middle South Operations Center in Pine Bluff, Arkansas. (CNO Exh. 39 at 3.)

2. *SEC Approval of the Middle South Reorganization Plan*

In 1949, the Securities and Exchange Commission ("SEC") approved the plan of reorganization, submitted under Section 11 of the Public Utility Holding Company Act ("PUHCA"), 15 U.S.C. § 79k (1981), pursuant to which MSU was created and was to own the common stock of NOPSI, AP&L, LP&L and

MP&L. *Electric Power & Light Co.*, 29 SEC 52, 67 (1949). The SEC found (29 SEC at 62, 67) that the plan would comply with the directives of section 11(b)(2) of PUHCA, which requires the SEC to ensure that the existence of a holding company "does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding company system." 15 U.S.C. § 79k(b)(2).

In 1953, the SEC found that the Middle South system constituted an "integrated public-utility system" within the meaning of sections 2(a)(29) and 11(b)(1) of the PUHCA. 15 U.S.C. §§ 79b(a)(29), 79k(b)(1). *In Re Matter of Middle South Utilities, Inc.* 35 SEC 1 (1953). Section 2(a)(20) defines an integrated public-utility system as one that is "physically interconnected . . . and which . . . may be economically operated as a single interconnected and coordinated system . . . in one or more states, not so large as to impair . . . the advantages of localized management, efficient operation, and effectiveness of regulation . . . ." 15 U.S.C. § 79b(a)(29).

Section 11(b)(1) of PUHCA directed the SEC

> (1) To require by order . . . that each registered holding company, and each subsidiary company thereof, shall take such action as the Commission shall find necessary to limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system . . . .

15 U.S.C. § 79k(a)(1).

In connection with its finding of integration, the SEC reviewed, *inter alia*, the system's interconnected transmission grid, its use of a central dispatch center, inter-affiliate sales, and off-system sales. 35 SEC at 7-10. As to generation planning on the system, the SEC found:

> The record indicates that the construction programs of the Middle South system are coordinated through an operating committee. This committee meets regularly and reviews and estimates the system loads for a period several years in advance. Estimates are also made of the required system generating capabilities and of the individual companies. On the basis of these estimates, the operating committee makes its recommendations to the individual companies' managements as to the installation of additional generating facilities and construction of transmission lines. The record indicates that this system planning has made possible the installation of larger generating units than would be feasible if each of the companies were operated as individual entities, and has also resulted in lower unit costs for the power produced as well as lower initial installation costs.

(*Id.* at 8.) The SEC concluded:

> Based upon the record developed in the Electric proceedings and supplemented by the instant proceedings, we conclude that the electric system of Middle South constitutes an integrated public utility system. In reaching this conclusion, we have considered the long historical record of unified operations of the electric facilities, the extent of regulation by State Commissions, and the fact that the system is not so large as to impair the effectiveness of regulation in any of the states in which the company operates. We have also considered the high degree of coordination which, in part, appears to be due to common control, leading in turn to common planning development.

(*Id.*)

In regard to retention of non-electric properties, the SEC noted that AP&L and MP&L had disposed of their gas operations prior to the proceeding (*id.* at 2) and ordered LP&L to divest its gas operations. (*Id.* at 14.) However, the SEC permitted NOPSI to retain its gas and transportation operations on the basis of governmental policies exercised by the City of New Orleans:

> New Orleans' operations of the electric, gas and transportation services are conducted pursuant to indeterminate permits granted by ordinances of the Commission Council of

> the City of New Orleans, supplementary to an ordinance adopted in 1922 commonly known as the "Settlement Ordinance." That Ordinance provides, among other things, for the establishment and continuing determination of the Company's rate base, the rate of return on the rate base, and the rates and fares to produce such return. It also provides that the City have a perpetual option to purchase parts or all of the property, at the rate base values.
>
> * * *
>
> The Commission Council of the City of New Orleans exercises complete regulatory jurisdiction over the Company with respect to rates, accounting, property acquisitions, and issuance of securities.
>
> The record contains an affidavit of the Commissioner of Public Utilities of the City of New Orleans which sets forth a statement of policy of the City concurred in by the Mayor of New Orleans and all the members of the Commission Council of the City. That statement of policy sets forth that the unified operation of electric, gas and transportation operations by New Orleans is the result of careful planning on the part of the City and is designed "to foster and safeguard the benefits which this City acquired for itself in connection with the 1922 reorganization." That statement of policy also sets forth that the City "has certain well defined legal rights to have the operations continue as they have" and that "for both legal and practical reasons therefor, the City will firmly enforce its rights and protect the benefits which it enjoys under the present local franchise situation."[39/40]

(*Id.* at 14-15.) The SEC concluded that "[i]n view of the expressed policy of the City with respect to its strong desire for continued unified operations, and in view of the New Orleans franchise situation" it would decline to order divestiture of NOPSI's non-electric facilities. (*Id.* at 15.)

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[39]The SEC itself has no ratemaking authority over NOPSI's sale of electricity. *See* SEC Release No. 23579, *In the Matter of Middle South Utilities, Inc.*, p. 421 (January 23, 1985).

[40]Certain names and terms, previously defined or abbreviated in the text, are set forth in full here as an aid to clarity.

3. *History of System Agreements*

For several decades, NOPSI and its affiliated operating companies have been parties to a series of agreements governing their power pooling arrangements. These agreements controlled the sales of power and energy between the companies, and were for the most part filed with and approved by the Federal Power Commission ("FPC"), the predecessor of FERC. (NOPSI Exh. 39 at 6.) Recent agreements have continued to reflect both the role and responsibilities of the individual companies on the system and the nature of the joint generation planning in which they engage. (NOPSI Exh. 39 at 6-15.)

When the decision to build Grand Gulf was made, the operative pooling agreement was the "1973 System Agreement." (NOPSI Exh. 35, MLH-15, Item 1.) NOPSI's witness Mr. Regis Trumps, a vice-president of MSS, testified as to the history preceding the 1973 System Agreement as described in the several quoted paragraphs below:

> Prior to 1951, power and energy transactions between the Middle South operating companies were accomplished through various FPC approved service schedules, which were documents setting forth the terms and conditions under which transactions were to occur. In 1951, AP&L, LP&L and MP&L adopted an agreement titled, "Memorandum Re Administration of Intra-System Transactions and System Planning and Development" ("Memorandum Re").

(NOPSI Exh. 39 at 6.) In 1971, Arkansas-Missouri Power Company ("Ark-Mo"), since consolidated into AP&L, also became a party to Memorandum Re. (*Id.*)

Mr. Trumps explained that the benefits sought to be achieved by the Memorandum Re included the following:

> the combined loads of the companies could be provided with less generating capacity; emergency conditions could be met with a lesser likelihood of severe symptoms; and more efficient generating equipment could be added and installed more economically.

(*Id.*)

NOPSI was not a party to Memorandum Re, but entered into a "similar agreement" with LP&L in 1956. (*Id.* at 6.) (Neither Memorandum Re nor the NOPSI-LP&L agreement is part of the record in this proceeding.)

The 1973 System Agreement was a system-wide pooling agreement that succeeded Memorandum Re. Mr. Trumps testified to its origin as follows:

> Memorandum Re was a reasonably sound agreement, but by the late 1960's it became apparent that a more formal pooling agreement, with up-to-date coordination concepts and pricing parameters, was necessary. An Ad Hoc Committee of one engineering and one rate representative from each operating company and a representative from MSS was appointed to draft what became the 1973 System Agreement. That System Agreement was tendered for filing and was accepted as a just, reasonable, and non-discriminatory rate schedule by the FPC.

(*Id.* at 7.)

As stated in Section 3.01 of the 1973 System Agreement, the purpose of that agreement was:

> to provide the contractual basis for the continued planning, construction, and operation of the electric generation, transmission and other facilities of the Companies in such a manner as to achieve the maximum possible economies consistent with the highest practicable reliability of service, with the reasonable utilization of natural resources and effect on the environment, and to provide a basis for equalizing among the Companies any imbalance of costs associated with the construction, ownership and operation of such facilities as are used for the mutual benefit of all the Companies.

(NOPSI Exh. 36, MHL-15, Item 1, p. 11.) The Agreement had three principal functions: (1) it set forth the responsibilities of the operating companies with respect to generation capability, generation planning and power and energy transactions (*see* Article

IV); (2) it provided service schedules to govern the power and energy transactions between the operating companies (*see* MSS-1 through MSS-5); and (3) it designated a Middle South Operating Committee ("MSOC") composed of a representative from each operating company and MSU and delineated its role in system planning (*see* Article V).

The anticipated benefits of the 1973 System Agreement, delineated in its Section 3.05, were similar to those of Memorandum Re:

> It is believed, based on experience, that by jointly planning on a system basis for the construction and operation of these major facilities:
>
> (a) The combined loads of the Companies can be supplied with less aggregate installed capacity; and
>
> (b) Installations of additional capacity can be made at lower cost because of the large unit sizes; and
>
> (c) The new installations will be more economical and require less operating labor and maintenance per KW because of the large unit sizes; and
>
> (d) The strengthened transmission system will make possible a fuller utilization of the capability of the lower cost generating units of the System; and
>
> (e) Emergency conditions in any part of the System or other systems in adjacent areas can be met with less probability of impairment of service to the general public.

(NOPSI Exh. 36, MLH-15, Item 1, p. 12, § 3.05.) Section 3.06 goes on to provide that, as a consequence of these anticipated benefits, it was intended that ". . . each Company shall be willing and able to provide its portion of the major facilities determined to be necessary and that each company shall share in the benefits and pay its share of the costs of coordinated operations. . . ." (*Id.* at 13.)

It is important to note that Section 4.01 of the agreement specifies, "Each Company shall normally own, or have available to it

under firm contract, such generating capability and other facilities as are necessary to supply all of the requirements of its customers." (*Id.* at 14.) According to Mr. Trumps:

> This principle recognizes the responsibility of each operating company to finance and construct or arrange for generation sufficient to meet its own load, just as it would have the responsibility to do in the absence of its participation in the power pool. Neither the affiliation of the MSU operating companies through their common parent, MSU, nor the existence of the [Middle South Operating Committee], which is assigned the task of coordinating System-wide planning, relieves any of the MSU operating companies from its public utility duty to serve its franchise load.

(NOPSI Exh. 39 at 16.)

In 1981, a revised system agreement was drafted by representatives of the operating companies. NOPSI and the other companies executed this agreement, known as the "1982 System Agreement," and filed it with the FERC in the spring of 1982. (NOPSI Exh. 39 at 8.) One of the objectives of the 1982 System Agreement was "to ensure that each MSU operating company has an appropriate share of coal and nuclear base generating units." (NOPSI Exh. 39 at 8.) Details of the 1982 System Agreement are discussed *infra*.

4. *Generation Planning On The System*

Mr. Trumps provided detailed testimony as to the nature of "the planning process utilized by the operating companies" at the time when the companies decided to build Grand Gulf I, as follows:

> 1. Each MSU operating company furnished the MSOC as frequently as required, but at least once a year, estimates of its peak load and energy requirements. The MSOC then consolidated these MSU operating company peak and energy forecasts into one Middle South System peak and energy forecast.

2. The MSOC also obtained from each of the operating companies its individual projections of future power supply capability and, after coordinating them, consolidated them, just as the load forecasts had previously been consolidated. A consolidated load and capability forecast was then produced for the overall power supply requirements of the System.

3. This coordination activity performed by the MSOC mainly addressed the installation schedule of generating units, the approximate size and general location of generating units, and considerations of purchases from other utilities.

4. The final decision as to the exact location of a power supply source, its fuel, and exact size was made by the individual operating company which had agreed to install the generating unit. The location and fuel could not usually be specifically determined until after land, environmental, and transmission studies had been made. Performing these necessary studies was the responsibility of the individual operating companies.

5. The consolidated plans were submitted to and approved by the chief executive officers of the companies. In addition, the Board of Directors of the operating companies approved the construction projects of their respective companies and the expenditures therefor. The individual operating companies then proceeded to secure and obtain such regulatory approvals as may have been required at the time and to finance, construct, operate, and maintain the particular generating units which had been scheduled for installation by them.

(NOPSI Exh. 39 at 16-18.)

The role of NOPSI in the process described by Mr. Trumps prior to 1973 is somewhat unclear in light of the fact that NOPSI was not a party to Memorandum Re. However, at least since the execution of the 1973 System Agreement, it appears that NOPSI and the other operating companies provided the MSOC with their load and capability forecasts, that the MSOC "coordinated" such

forecasts and determined the need for new generating units, that such plans were approved by the chief executive officers of the operating companies, and that each individual company determined the specifics of the generating unit undertaken by it and ultimately approved its construction and budgets.

Mr. Cain testified similarly as to generation planning on the Middle South System in a proceeding before the LPSC in 1983. (CNO Exh. 30(c).) He stated that each operating company was required to plan for its own generation additions and prepared, among other things, load forecasts and customer density studies. Its forecasts were then coordinated with those of the other operating companies by the MSOC. The MSOC then issued an "interim assignment" of a generating unit which was presented to the individual operating company board for final approval. (*Id.*) In Mr. Cain's words:

> An interim assignment of that generation is made to a particular operating company and then it is the decision of that operating company's board of directors to finalize that decision and proceed with the implementation of that decision.

(*Id.*) The operating company independently selected "the size, type and location of the generation units." (*Id.* at 29.)

Mr. Cain stated that "the ultimate, final decision rests with the operating company." (*Id.* at 27.) Further, an operating company could reject a decision of the MSOC (*id.*), just as NOPSI decided against the Alligator Point plant on the basis of site studies (discussed in greater detail below), and as LP&L had rejected the assignment of the St. Rosalie plant. (*Id.*)

5. *Cost Allocation Under The 1973 System Agreement*

The 1973 System Agreement contained two principal mechanisms for the allocation of the cost of certain electric production among the operating companies. Service Schedule MSS-1 to the agreement, entitled "Capability Equalization," purported to

"equalize" generating capability (capacity) among the companies "so that the capability of each company after equalization [would] be equal to its Capability Responsibility." (NOPSI Exh. 35, MLH-15, Item 1, p. 1-1.) Service Schedule MSS-3, entitled "Exchange of Electric Energy Among the Companies," set forth a pricing formula for energy bought and sold on the system by the operating companies. (*Id.* at 3-1.)[41]

The term "equalization" is somewhat a misnomer in the context of the agreement. Capability "equalization" under MSS-1 spread the generating capacity on the system among the four operating companies in proportion to the relative size of their loads. By sharing the costs of *certain* generation plants termed "Participation Units" (which were defined as newly built generation units, some of the capacity of which was in excess of the needs of the operating company that owned it), each company became responsible for a *number of MWs* of system capacity in proportion to its own load. However, because each company was solely responsible for the costs of its own generating plants (in addition to a possible share of Participation Units), and because the costs of such plants were not identical, the capacity *costs* paid by one company could and did vary significantly from that of another company, and were *not* "equalized."

The formula contained in MSS-1 turned on the defined term "Capability Responsibility."[42] A company's Capability Responsibility was determined by first calculating its "Responsibility Ratio"—a measure of the peak load of the company, relative to others' loads. It was calculated by establishing a ratio of the

[41]Three other service schedules were attached to the 1973 System Agreement: (1) MSS-2, "Transmission Equalization"; (2) MSS-4, "Distribution of Revenue From Sales Made For The Joint Account Of All The Companies"; and (3) MSS-5, "Distribution Of Operating Expenses Of Systems Operations Center."

[42]"Capability Responsibility" was defined in Section 2.13 of the 1973 System Agreement as "the System Capability multiplied by the Responsibility Ratio for that Company." (*Id.* at 8.)

average of each company's four highest non-coincident peak demands[43] to the total peak demand of the system. (NOPSI Exh. 39 at 11.) For example, NOPSI's peak demands have been roughly 9% of the system total, and, accordingly, its responsibility ratio has been approximately 0.09. (*See, e.g.,* CNO Exh. 30(c) at 96.)

The next step was to determine System Capability, defined as the sum of MWs that could be produced by the four companies' generating units or that were under contract. (*See id.,* p. 7, §§ 2.08, 2.09.)[44] A company's Capability Responsibility could then be derived by multiplying the System Capability by its Re-

[43]Section 2.10 of the 1973 System Agreement provided:

> *Company Load Responsibility* shall be as follows:
>
> (a) The average of the four highest clock-hour demands in megawatts of a company's system, each on a different day, occurring during the twelve-month period ending with the current month, but not less than 90% of the average of the four highest such demands occurring during the twenty-four (24) month period ending with the current month, where each such demand shall represent the simultaneous hourly input from all sources into the system of a company less the sum of the simultaneous hourly outputs to the systems of other interconnected utilities. (Company demands shall include firm power supplied to other systems for its own account.)
>
> (b) Less the power supplied to others as sales for the joint account of all the Companies.
>
> (c) Less the contractual amount of firm purchases with reserves available during the month from other systems for its own account.

Section 2.11 provided:

> *System Load Responsibility* shall be the arithmetical sum in megawatts of the individual Company Load Responsibilities.

[44]Section 2.08 provided:

> *Capability* shall be the net output in megawatts that can be produced by a generating unit under the conditions specified by the Operating Committee, or the input in megawatts available under contract from a supplying source.

(Footnote continued on following page)

sponsibility Ratio. If a company had (by ownership or contract) *less* generation capability than its Capability Responsibility, it would be considered "*short*"; if it had *more*, it would be considered "*long*."

Under Section 10.03 of MSS-1, the excess capability (over its Capability Responsibility) of each "long" company would be "allocated to each deficient Company in the ratio of such Company's deficiency to the sum of the deficiencies of the deficient Companies." (*Id.*) The cost of the allocated capability, as determined by Section 10.05 of MSS-1, was based on the monthly fixed costs of the company's "Participation Unit." As previously indicated, "Participation Unit" was defined as the "most recently installed" unit or units owned by a company. (*Id.* at 1-3, § 10.04.)

Thus, to effect capability "equalization," short companies were required to make payments to long companies based on (1) the number of MWs by which they were short and (2) the capital cost of MWs associated with the long companies' participation units.[45] (*See* NOPSI Exh. 39 at 11.) In return for its payments, the short company received an entitlement to the energy generated at the Participation Unit in proportion to the capability allocated to the short company from such plant. MSS-1, § 10.04(b), pp. 1-3 to 1-4.[46]

(Footnote continued from previous page)

Section 2.09 provided:

> *System Capability* shall be the arithmetical sum in megawatts of the individual Company Capabilities.

[45]Under the Schedule MSS-1, a company could be considered short and required to make equalization payments to long companies, even when it had adequate generation of its own and no need for the long company's capacity. Such a situation could arise when, as today, excess capacity exists on the system and each company is obligated to pay for a portion of the excess as part of its Capability Responsibility.

[46]During most of the 1970's, NOPSI was a long company and received payments from the short companies calculated on the basis of the costs of its Michoud 3 plant.

The dispatch of generating plants and the pricing of energy bought and sold between the companies were governed by Service Schedule MSS-3. Section 30.02 of MSS-3 provided that the System Operator would "dispatch" (that is, utilize) the plants in the system to obtain the lowest cost energy for all the companies, *i.e.*, the lowest variable cost units would be dispatched first. Section 30.03 provided that, for billing purposes, the dispatched energy would be allocated on an hourly basis, first to the Company owning the unit (unless such energy was excess from a long company's Participation Unit) and second "to supply the requirements of the other Companies (pool energy)." (*See* CNO Exh. 29 at 237.) Excess energy from a long company's Participation Unit was considered the entitlement of the short companies, in proportion to their capability allocation from such unit, and was known as "entitlement energy." (*Id.*) The pricing of energy exchanged between the companies was determined by Section 30.06 of MSS-3. (*Id.* at 3-3.) Entitlement energy from Participation Units was priced at the cost of fuel to generate such energy. (*Id.*, Section 30.06(a).) Pool energy was priced at the cost of fuel plus an adder. (*Id.*, Section 30.06(b), (c).)

6. *Impact of Generation Decisions on Relative Company Costs*

The foregoing provision for joint system planning and the allocation of capability have not produced a common cost of service among the operating companies. Capacity costs have been shared only when the plant involved was a Participation Unit of a long company, only to the extent the company was actually long, and only by companies that were short. (NOPSI Exh. 30, MLH-15, Item 1, pp. 1-1 to 1-5.)

Rather, the decisions made by each operating company as to particular generating plants it built or contracted for had great impact on its costs of service (CNO Exh. 29 at 233), and there has been a wide disparity in those costs among the companies. NOPSI's Senior Vice President, Mr. Hurstell, specifically confirmed that an individual operating company's decision as to choice of generation sources affects its costs of electricity. (CNO Exh. 29 at 232.)

Moreover, under the 1973 System Agreement, each operating company was responsible for making "the necessary financial arrangements" to proceed with construction of generation units assigned by the MSOC. (NOPSI Exh. 36, MLH-15, Item 1, p. 15.) Mr. Cain testified that a company was "responsible for the costs associated" with a plant "for which [it had] responsibility." (CNO Exh. 30(c) at 102.) Also, costs other than those of generation contributed to a company's total cost of electricity.

Disparities among the operating companies' costs have been substantial. Over the period 1965 to 1982, NOPSI's average costs of service were the *highest* on the system, exceeding those of AP&L, for example, by over 50%. (CNO Exh. 30(c) at 126.) The costs of electricity to the four companies during that period were:

Operating Company	Cost of Service (per kWh)
NOPSI	6.2
MP&L	6.045
AP&L	4.878
LP&L	3.96

(*Id.*) (Based on the Grand Gulf allocation agreed to by NOPSI in 1980, this disparity was projected in 1983 to *increase* for the period 1983-1992.)[47]

Thus, NOPSI's status as a member of the MSU "system" did *not* obviate the need for its management to exercise *critical judgment* and act *prudently* in meeting NOPSI's duty to provide economical electric service to the ratepayers of New Orleans in accordance with its public utility and specific franchise obligations. In testifying before the LPSC in 1983, NOPSI's witness here, Mr.

[47]NOPSI, again the highest cost company, would have a total average cost of 16.35 /kWh compared to only 6.73 /kWh for AP&L. CNO Exh. 30(c), p. 127. NOPSI's witness here, Mr. Louiselle, testified before the LPSC in 1983 that Middle South and NOPSI have operated so that NOPSI's ratepayers had incurred the highest electricity costs since at least 1965 (CNO Exh. 33, p. 858).

Bruce Louiselle (then a consultant to the LPSC), testified as to how NOPSI had fared in meeting its obligations to its ratepayers as follows:

Q. Mr. Louiselle, I wonder if we can focus for a moment on all that Middle South and NOPSI have done lately for NOPSI's ratepayers. First, Middle South has assigned an excessive allocation of Grand Gulf power to NOPSI, is that correct?

A. Yes.

Q. And NOPSI has acquiesced, is that true?

A. Yes.

* * *

Q. Now, the second thing that Middle South and NOPSI have done to NOPSI's ratepayers is to allow AP&L out of its obligation to take an allocation of Grand Gulf, is that correct?

A. Yes.

Q. And NOPSI's ratepayers will incur greater costs as a consequence of that action, is that true sir?

A. Yes.

Q. The third thing that Middle South and NOPSI have done to NOPSI's ratepayers has been to operate their system in a way that's enabled NOPSI to have the highest electricity costs on the Middle South system, at least since 1965, to the present, is that true sir?

A. Yes, I believe that is an accurate statement. Their costs have been higher than any other Operating Company since that period of time.

* * *

Q. Now, the fourth thing that Middle South and NOPSI have done for NOPSI's ratepayers is that they have arranged for NOPSI to own absolutely no low cost coal-fired generation at least for the rest of this decade, is that true sir?

A. Yes.

Q. NOPSI presently owns no coal-fired generation, is that correct?

A. Other than their unit power purchase of White Bluff, that's correct which expires or is set to expire when Grand Gulf goes on line.

Q. And that's not an ownership interest of course is it?

A. That's correct, it's not.

(CNO Exh. 33 at 585-860.)

B. *NOPSI's Generation Needs And Projections in 1974*

NOPSI is and has been the smallest of the four operating companies on the Middle South system.[48] In 1974, with an actual peak load of only 869 MW, NOPSI was roughly half the size of MP&L, the next smallest operating company, and less than one-third of the size of AP&L and LP&L, respectively. (NOPSI Exh. 36, MLH-5B, September 11, 1974 Forecast.) While NOPSI's service territory is limited to Orleans Parish, its sister companies serve larger areas throughout their respective states and have supplied power to utilities off the Middle South system. (*See* CNO Exh. 29 at 34-35.) Moreover, during the early 1970's NOPSI was projecting slower growth than its affiliates. The 1974 system forecasts projected NOPSI's load to grow 260 MW, or 27%, from 1975 to 1980. The system growth was projected to be 5828 MW, or 60 percent, during that period. LP&L, the company with the highest projected growth rate, was projecting growth of 2239 MW, or 72 percent. (NOPSI Exh. 36, MLH-5B, 9/11/74 Forecast.)

During the 1970 to 1974 period, NOPSI's forecast of its 1980 load actually decreased by about 60 percent. NOPSI's annual projections for its 1980 load were as follows:

[48]Ark-Mo, which has since been absorbed by AP&L, had a very small load (*e.g.*, 284 MW in 1973). (NOPSI Exh. 35, MLH-5B, 10/4/73 Forecast.)

Date of Forecast	Projected NOPSI Peak Load for 1980 (MW)
10/01/70	1800
10/11/71	1570
9/28/72	1570
10/04/73	1405
9/11/74	1210

(NOPSI Exh. 35, MLH 5-A and MLH 5-B.) The total system projections decreased during the same period, but by about only 9 percent. In 1970, the system total load projected for 1980 was 16748 MW, which projection dropped to 15453 MW by 1971 and 15277 MW by 1974. (*Id.*)

In 1974, NOPSI operated eleven oil and gas generating units with a combined capacity of 1257 MW. NOPSI's newest and largest unit, Michoud Unit 3, was completed in 1967 with a capacity of 548 MW—about 60 percent of NOPSI's 1974 peak load. NOPSI's oldest units at Market Street and Patterson were constructed during the 1930's and 1940's and were expected to be retired in the 1980's.

In 1974, NOPSI was a long company under the 1973 System Agreement. Michoud 3, with a capacity cost of less than $100/kW, was a participation unit. (Tr. 1046.) With no planned capacity additions of its own, however, NOPSI would be a "short" company by 1980, when Grand Gulf I was expected to become operational. (Tr. 1047.)

C. *The System's Generation Needs And Projections In 1974*

As indicated in the previous section, the Middle South system in the early 1970's was projecting rapid growth of the combined loads of the operating companies throughout the decade and into the 1980's. According to Mr. Hurstell, the system had experienced an annual increase in its peak load of approximately 10 percent in the 1960's. (NOPSI Exh. 36 at 12.) Although its 1974 projection had fallen off slightly, the system was still projecting

annual growth approaching 10 percent through 1989. The system estimated that its projection of 9506 Mw for 1975 would be exceeded by 61 percent in 1980 (15277Mw), by 147 percent in 1985 (23456 Mw), and by 253 percent in 1989 (33539Mw). (NOPSI Exh. 36, MLH-5B, 9/11/74 Forecast.)

D. *Decision to Build Nuclear Plants—Including Grand Gulf—And Coal Plants*

In 1970 and 1971, the MSOC determined that the system load forecasts required the construction of additional generation capacity. (NOPSI Exh. 36 at 6.) According to Mr. Hurstell, the "additional capacity" was needed primarily to serve future growth". (*Id.*) The capacity was also needed for "fuel diversity" (*id.*), which Mr. Hurstell defined as movement away from reliance on the system's gas and oil fired generation. (CNO Exh. 29 at 214.)[49]

Prior to the 1970's substantially all of the system's generating facilities were built to burn natural gas or oil as a primary fuel. However, throughout the late 1960's and early 1970's, the supply of natural gas for electric generation became increasingly scarce. Pipelines became reluctant to commit to long-term supplies and eventually curtailed deliveries to several of the operating companies. (NOPSI Exh. 35 at 3, 6; NOPSI Exh. 36 at 7.)

In 1970, United Gas Pipe Line Company ("United"), then the exclusive supplier of natural gas to NOPSI, filed a plan with the Federal Power Commission ("FPC") to curtail service to NOPSI. In 1971, United filed an application with the FPC to abandon service to NOPSI. In 1973, the FPC issued curtailment guidelines for natural gas pipelines, such as United; these accorded the lowest priority to utility usage. In 1975, NOPSI's gas contract with

[49]Mr. Hurstell also testified that the additional capacity was further needed to replace capacity which would become obsolete in the future. *Id.* However, in 1974 the system was expecting to retire only 103 Mw—NOPSI's Market Street plant—in the next 15 years. (*See* NOPSI Exh. 36, MLH-5B, 9/11/74 Forecast.)

United expired and was replaced by a new agreement that substantially increased the price NOPSI was required to pay for natural gas. NOPSI Exhibit 36, p. 7.

Additionally, the Arab oil embargo of 1973 caused a rapid increase in the cost of oil and raised the prospect that the price of oil, like that of gas, would be subject to large fluctuations. (NOPSI Exh. 35 at 61, NOPSI Exh. 36 at 7.)

The foregoing developments caused the Middle South System to decide to move away from oil and gas as generation fuels. (NOPSI Exh. 36 at 12.) Although Mr. Cain testified that the goal of the System was to move to a "50-50 mix" of nuclear and coal generation (CNO Exh. 30(c) at 98), NOPSI itself made no commitment to participate in a coal-fired unit, and had in fact no prospect of participating in such a unit for at least a decade.

In the late 1960's, LP&L and AP&L had committed to install three nuclear units, Waterford 3 (1165 Mw) and Arkansas Nuclear ("ANO") Units 1 and 2 (totalling approximately 1800 Mw), respectively, with completion of the first ANO unit expected to be in 1974. In 1973, AP&L committed to a series of 700 MW coal units, the first of which, White Bluff 1, was scheduled for completion in 1978. (NOPSI Exh. 36, MLH-5B, 11/9/74 Forecast.)

Mr. Hurstell testified that, despite these undertakings, the MSOC determined that additional capacity of 1400 and 1625 Mw should be added in 1978 and 1979, respectively. (NOPSI Exh. 36 at 12.) In 1971, the MSOC commissioned a study of generation alternatives for an additional 1400 Mw of capacity by 1978. The study, entitled "Evaluation of Alternate Generating Capacity Additions," indicated that the most economic choice would be a 1250 Mw nuclear unit. (NOPSI Exh. MLH-6.) On the basis of this study (NOPSI Exh. 36, MLH-6), the MSOC in 1971 determined that two 1250 megawatt nuclear generating units should be constructed. The first was to be at the Grand Gulf site in Port

Gibson, Mississippi and to be owned by MP&L. The second was to be constructed by NOPSI at Alligator Point in eastern New Orleans. (NOPSI Exh. 36 at 13-14.)

In 1971, a joint committee of MP&L and NOPSI was organized to begin planning the two nuclear units. Shortly thereafter, the committee retained Bechtel Power Corporation ("Bechtel") as architect/engineer for the units. In 1972, Bechtel advised that poor subsurface conditions of NOPSI's Alligator Point site would result in increased costs for the NOPSI unit. (NOPSI Exh. 36 at 14.) The September 11, 1972 minutes of the NOPSI Board of Directors indicate that Senior Vice President M.L. Cade made a presentation in which he indicated that it was necessary to abandon the proposed plant due to the results of the Bechtel study. More broadly, he noted, "steeply rising costs of nuclear plants have thrown a cloud on their possible future use on the Middle South System." (CNO Exh. 42 at 2.) NOPSI withdrew the Alligator Point plant from further consideration in August 1972. (NOPSI Exh. 36 at 14.)

In late 1972, MP&L undertook project management of both proposed nuclear units—to be known as Grand Gulf I and Grand Gulf II—at its Grand Gulf site in Mississippi. (NOPSI Exh. 36 at 15.)

E. *Commitments To Grand Gulf Under The Availability Agreement*

The projected costs of the Grand Gulf units were apparently too large to be financed by any individual company. Mr. Hurstell testified that the projected cost of the first unit alone was $656 million, or roughly one and a half times MP&L's rate base. (NOPSI Exh. 36 at 15.) Mr. Cain testified that it would have been "extraordinarily difficult, if not impossible" for NOPSI and MP&L to finance the two 1250 MW units. (NOPSI Exh. 35 at 8.)

It was determined to utilize the support of all the operating companies to finance the Grand Gulf project. This could have taken one of several forms, but it was decided to create a new MSU subsidiary for this purpose. In February 1974, MSE (SERI) was incorporated. (NOPSI Exh. 35 at 8.) In June 1974, MSE purchased the Grand Gulf project from MP&L for $20 million, but immediately contracted for MP&L to act as agent to design, construct and operate the project. (NOPSI Exh. 36 at 16.) Although the operating companies contemplated that MSE would own other base load capacity, MSE's only ownership interest to date has been the Grand Gulf plant. (*Id.*)

NOPSI and the other operating companies committed the backing necessary to finance the Grand Gulf project in June 1974, by executing the "Availability Agreement." (NOPSI Exh. 36, MLH-15, Item 2.) The Availability Agreement provided that MSE would use its best efforts to construct the Grand Gulf project (*id.*, Section 2) and, upon completion, make its output available to the operating companies. (*Id.*, Section 3.) In return, NOPSI and the other operating companies committed to pay for the output of the project in an amount equal to the total costs (plus a return on investment) that MSE incurred in supplying the power and energy. (*Id.*, Section 4.) Mr. Cain testified:

> My understanding of the purpose of the Availability Agreement was to contractually bind the operating companies of Middle South Utilities to a fiduciary pledge of financial responsibilities of financing Grand Gulf 1 and 2. (Tr. 482-483.)

* * * *

Section 4 of the Availability Agreement provided that the operating companies' entitlement to, and their obligation to pay for, the output of Grand Gulf would be governed by the "then applicable requirements of the System Agreement (or any agreement substituted therefor)." (NOPSI Exh. 35, MLH-15, Item 2, Section 4; Tr. 486.) Thus, this means that the allocation of Grand Gulf's output and costs would be made such that "short" companies would be obligated to purchase Grand Gulf output in proportion to their capability deficiencies. (NOPSI Exh. 35 at 12-13, NOPSI Exh. 36 at 17-18.)

The Availability Agreement was the first of its kind on the Middle South System. (Tr. 486.) MSE's role as a long company was also unique in that it would have no "capability responsibility" because it had no load. (NOPSI Exh. 36 at 18.) It therefore would always be a long company to the full extent of its generating capacity, and "all of the Grand Gulf capacity and energy would be purchased by the operating companies in proportion to their relative deficiencies in capability." (*Id. see* Tr. 1045.)

As a result of these circumstances and NOPSI's projected status as a short company at the time when Grand Gulf would become operational, NOPSI knew in 1974 that it would be obligated to purchase a "substantial amount" of Grand Gulf capacity "in the early years when Grand Gulf capacity was relatively expensive." (NOPSI Exh. 36 at 18.) Nevertheless, NOPSI could not determine the amount of its commitment. NOPSI's obligation could not be expressed in numbers of megawatts or as a percentage of the plant, and NOPSI could not ascertain its monetary exposure when it executed the Availability Agreement. (Tr. 547, 549.)

In addition, the Availability Agreement set no purchase price for Grand Gulf's output, or any cap on such price. The contract called for complete reimbursement of MSE's expenses without limitation as to how high those expenses might be, without penalties for cost overruns or limits on the exposure of the operating companies. (*Id.*)

Moreover, the operating companies agreed to pay all of MSE's costs if Grand Gulf were "not in service for any reason." (*Id.* Section 4.) They agreed to pay if Grand Gulf became permanently shut down, including shut-down and perpetual maintenance costs. They agreed to pay specified amounts if Grand Gulf did not enter into service by December 31, 1982. (*Id.*, Section 4 and 5.) The short companies would be responsible to pay for the entire fixed charges of the plant even if no power were ever delivered from it. (Tr. 442, 569.)

As required by PUHCA, MSU filed the Availability Agreement with the SEC, which approved it by order dated June 4, 1974. *Middle South Utilities,* SEC Public Utility Holding Co. Act Rel. No. 18, 437 (Jan. 4, 1974) (NOPSI Exh. 35 at 8-9; NOPSI Exh. 36 at 16-17; 27-28, 36.) NOPSI did not request or secure the Council's approval of its entering into the Availability Agreement. (Tr. 487.)[50] In fact, the Council did not become aware of the nature of NOPSI's commitment until 1980.

On the strength of the Availability Agreement, MSE secured the financing needed to construct the project.

MP&L and MSE jointly petitioned the MPSC for a certificate of public convenience and necessity authorizing construction and operation of the Grand Gulf project. The MPSC issued an order granting a certificate in May 1974, and site preparation commenced. (NOPSI Exh. 36, MLH-19-A at 2-14.) In September 1974 the AEC issued construction permits for both Grand Gulf units. (*Id.*) In December construction of the reactor building began, and Bechtel issued its "Definitive Cost Estimate and Schedule" forecasting completion of Grand Gulf I by January 1980 at a cost of $854 million. (*Id.*)

F. *Generation Capacity Additions By Other Operating Companies In The 1970's*

The first major units, other than oil and gas units, to commence service on the system were AP&L's nuclear ANO Unit 1 and Unit 2 in 1980 (836 MW and 858 MW capacity, respectively). Planning of these units had commenced in the 1960's. LP&L's planning process for its 1104 MW Waterford 3 nuclear unit was running over one year ahead of Grand Gulf, but initiation of heavy construction of Waterford 3 was delayed until late 1975. (Waterford 3 went into service in September 1985). In 1974,

[50]This circumstance is the subject of a legal action pending in Louisiana state court. *City of New Orleans v. New Orleans Public Service, Inc.*, No. 84-4767 (Civ. Dist. Ct. for the Parish of Orleans).

LP&L announced its plans to construct another nuclear plant, known as the St. Rosalie project, the two 1160 NW units of which were projected to enter into service in 1983 and 1985, respectively. (NOPSI Exh. 36, MLH-5-B, 9/11/74 Forecast.) The St. Rosalie project was cancelled, however, in 1975.

AP&L built four coal units known as White Bluff Units 1 and 2 and Independence ("ISES") Units 1 and 2. AP&L initially applied to the APSC for a Certificate of Environmental Compatibility and Public Need for four units at the White Bluff site in 1973. (NOPSI Exh. 40 at 3.) In 1974, AP&L was granted a certificate for two of those units. (*Id.*, p. 4.) In 1977, AP&L and two co-applicants filed for a certificate for two identical units at the Independence site. (*Id.*) The APSC granted that certificate in 1978. (*Id.*, p. 5.)

In the mid 1970's AP&L was apparently experiencing difficulties in financing its construction program, and in August 1975, it halted construction of White Bluff. (NOPSI Exh. 40 at 5.) AP&L was subsequently approached by several smaller power systems and eventually entered into contracts to sell undivided ownership interests in the plant "off the system" as depicted in the following table.

Buyer	Date of Contract	Percentage Ownership	MW Ownership (approximate)
Arkansas Electric Cooperative Corp. ("AECC")	6/27/77	35	560
Jonesboro, Ark.	6/27/77	5	80
Conway, Ark.	6/29/87	2	32
West Memphis, Ark.	1/18/80	1	16

(NOPSI Exh. 40 at 6.) Construction resumed, and the units entered into commercial operation in 1980 and 1981 respectively.

At the time of its ISES application, AP&L had entered into a co-ownership arrangement for the two ISES units with AECC

and the City of Jonesboro. (*Id.*, p. 6.) AP&L subsequently executed similar agreements with three other parties, so that by January 1980 the following systems had ownership interest in ISES:

Buyer	Percent Ownership	MW Ownership (approximate)
AECC	35	560
Jonesville, Ark.	5	80
Conway, Ark.	2	32
West Memphis, Ark.	1	16
Osceola, Ark.	0.5	8

(NOPSI Exh. 40 at 6-7.)

At least as early as January 1980, MP&L was actively considering a purchase of part of AP&L's coal units. On June 1, 1980, AP&L was apparently unable to make payments for the construction costs of White Bluff 2 and ISES 1 and 2. Pursuant to the ownership contracts for those plants, AECC advanced such funds. Absent reimbursement from AP&L by June 1, 1982, AECC would have been entitled to increase its ownership share of the units in proportion to its contributions. (NOPSI Exh. 40 at 7-8.)

Mr. Trumps testified that, in order to assure that the system-owned share of the coal-fired ISES plant would not be reduced, AP&L sold 25% of the ISES units to MP&L. (*Id.*, p. 8.) The two companies executed a Memorandum of Understanding with respect to this sale on July 21, 1980. (*Id.*, p. 9.) ISES 1 entered commercial operation in January 1983, as did ISES 2 in December 1984. (Tr. 987.)[51]

NOPSI made no attempt to explore or seek ownership arrangements for White Bluff or ISES, as did AECC, the Arkansas Cities and MP&L. (CNO Exh. 31 at 15.) NOPSI did not seek to purchase an ownership interest in any existing or planned system

[51]In a separate arrangement agreed to in 1984, AP&L sold MP&L 31% of the output of Independence 1 for a five-year period. (Tr. 813.)

coal plant, except for Wilton I described below. (Tr. 814.) Other than a short-term purchase of White Bluff output (noted below) NOPSI made no effort to purchase coal capacity either on or off the MSU system. (Tr. 815.)

On January 1, 1983, NOPSI made a short-term purchase of approximately 70 MW of the output of White Bluff until Grand Gulf came on line. (Tr. 814.) (NOPSI's witness here, Mr. Louiselle, previously questioned the wisdom of this transaction on the ground the NOPSI would have received substantially the same energy under the economy energy provision of the System Agreement, without payment of capacity charges.) (CNO Exh. 33 at 869.)

There were also plans in the mid 1970's to construct four additional 800 MW coal units in Louisiana, which would become operational in the mid-to-late 1980's. Their construction has repeatedly been postponed. (NOPSI Exh. 36, MLH-5-B.) NOPSI claims that it had plans to take 10% or 80 MW of the output of one of these plants (Wilton 1) beginning in the late 1980's. (Tr. 499–500.) However, no firm commitment was ever made, and it appears that construction of these units was never initiated.

G. *Cost Estimates And Forecasting*

Bechtel, the principal constructor of and engineer for Grand Gulf, was also responsible for making cost estimates which were submitted to MP&L and then to MSE. (CNO Exh. 20 at 36, 39.) NOPSI wholly relied upon MSE for Grand Gulf cost forecasting. (Tr. 650.) NOPSI had a major interest in the project costs, since it was a committed buyer of power and ultimate payor of Grand Gulf construction costs. (CNO Exh. 28 at 39, 40; CNO Exh. 29 at 112–13.) Nevertheless NOPSI management was apparently unaware of the methods by which cost estimates were made, the underlying assumptions, and whether certain cost-relevant events were reflected in the cost estimates it received. (CNO Exh. 28 at 40–41; Tr. 709; CNO Exh. 29 at 164.)

Throughout the course of construction, the projected completion costs of Grand Gulf increased relentlessly. (NOPSI Exh. 36, MLH-18.) The Definitive Cost Estimate for Grand Gulf I in 1974 had been $854 million. The official cost forecast issued in December 1978, over a year before NOPSI made a fixed commitment to Grand Gulf, was $1.310 billion. Inexplicably, no official cost estimates were issued during 1979, the year in which the Three Mile Island incident occurred. In February 1980, the official cost forecast for Grand Gulf Unit I was $1.773 billion, over 100% higher than originally estimated. (NOPSI Exh. 36, MLH-19A at II-15 to 17.)[52]

Bechtel's contract allowed it to pass on the rising costs of Grand Gulf to MSE. (Tr. 651.) MSE, in turn, intended to pass on these costs to the operating companies, including NOPSI. NOPSI, in turn, proposed to pass on these costs to the ratepayers. (Tr. 661-62.)

H. *Nuclear Plant Cost-Estimation Techniques*

The conventional method used by industry to project the completed costs of nuclear plants was "engineering estimation"—a technique that relied upon calculations and judgments as to time, material, and labor, based upon the design of the project. (Tr. 1755.) Bechtel used such a method to make forecasts for Grand Gulf. (Tr. 714.) By the mid 1970's it had become apparent that the engineering estimation method invariably resulted in substantially underestimating nuclear plant costs. (Tr. 1769-70.)

A key problem in nuclear plant cost forecasting lay in making adequate allowance for the expanding and changing regulatory requirements that were driven by widespread concerns over nuclear safety. (Tr. 1760.) The "contingency" allowances that Bechtel included in its cost estimates contained no allowance for increased costs due to regulatory changes. (NOPSI Exh. 36, MLH

[52]Completed costs of Grand Gulf I in 1985 were in excess of $3.6 billion.

19A at V-35.) NOPSI's management apparently did not know this, because it never undertook to question or examine the cost estimates received.

In the mid 1970's studies of the cost of nuclear plants were released from several sources that used a standard form of statistical analysis ("regression and analysis"). These results showed that nuclear plant costs were increasing at rates *far* in excess of those being shown by the industry-sponsored conventional methods. The first such study was published in 1974 by Professor I.C. Bupp of the Harvard Business School in conjunction with a group at M.I.T. (Tr. 1651-52.) Two similar studies were published by William Mooz of the Rand Corporation in 1978 and 1979. (Tr. 1652.) In additional, a book using regression analysis to analyze nuclear and coal plant on-line capacity factors was published in 1976 by Charles Komanoff, a witness here. In 1978 Mr. Komanoff's analysis of nuclear plant capital costs was set forth in state regulatory testimony and reported in *Nucleonics Weekly,* a widely read industry periodical (Tr. 1507-8), and shortly after the Three Mile Island incident, in Congressional testimony. Although NOPSI purported to be familiar with then-current studies on nuclear and coal plant costs (Tr. 757), the contrary appears to be the case. NOPSI remained unaware that the credibility of the methods employed by Bechtel and the industry generally had been seriously undercut by contemporaneous studies and data. (Tr. 721.)

I. *Growing Concern Over Gas And Oil As Generation Fuels*

During the mid 1970's, there were a number of federal legislative and executive actions taken to discourage electric utilities' use of oil or natural gas as a boiler fuel. (NOPSI Exh. 35 at 6-7.) In 1978, the Power Plant and Industrial Fuel Use Act, Public Law No. 95-620, 92 Stat. 3289, was passed. It prohibited the use of natural gas in existing power plants after January 1, 1990 and the construction of any major new plants burning either oil or natural gas. (NOPSI Exh. 36 at 8.)

Moreover, NOPSI was having difficulties in obtaining gas as a fuel for its power plants. (CNO Exh. 29 at 78.) Oil and gas prices were continuing to rise. The Iranian revolution in 1979 raised additional concerns about the availability of oil. (Tr. 664.)

The increased price of gas and oil, the Fuel Use Act, the lack of gas, and the Iranian situation did not, it should be noted, alone or together, affect the choice available to NOPSI between nuclear and coal based power generation. (Tr. 677.)

J. *The Three Mile Island Incident*

On March 28, 1979 an accident occurred at Unit II of the Three Mile Island nuclear plant south of Harrisburg, Pennsylvania, the worst accident in the history of commercial nuclear power generation. Within two weeks, the President approved a "President's Commission on the Accident at Three Mile Island." (Tr. 1272.) The incident focused the nation's attention on nuclear safety issues and resulted in calls for the reorganization of the Nuclear Regulatory Commission and for new actions to ensure nuclear safety. The Three Mile Island incident had an immediate and profound effect on nuclear plant regulation and "came to dominate thoughts in nuclear regulation for the balance of that year and during the time since." (Tr. 1277.)

The report of the President's Commission was released in October 1979, and contained serious criticism of the NRC. (Tr. 1294.) More broadly, the Three Mile Island incident precipitated a wide-ranging review of the whole structure of nuclear regulation beginning in 1979, and it had major cost implications for nuclear plants, including the Grand Gulf project. (Tr. 1342–43.) The circumstances surrounding the Three Mile Island incident and its impact on NOPSI's situation are discussed in more detail, *infra*.

K. *NOPSI's Decision To Take A Large Fixed Share Of Grand Gulf*

In January, 1980, approximately nine months after the Three Mile Island incident, NOPSI committed to take large fixed shares of both Grand Gulf I (335 MW) and Grand Gulf II (335 MW), aggregating 670 MW. Its share of Grand Gulf I was approximately 29.8% of the aggregate taken by all Middle South operating companies, notwithstanding that NOPSI had only 9% each of the combined load and combined assets of the system. Not all the events and considerations surrounding the allocation decision are clear, and there have been conflicting statements as to why NOPSI accepted so large a share. In reviewing the facts below, it should be noted that there are two distinct components to the 1980 allocation decision—one making each company's share of Grand Gulf *definite*, since the share had remained unquantified since 1974; and the other setting the *magnitude* of each company's share.

As previously indicated, it had initially been planned that MSE would become a party to the 1973 System Agreement. MSE's entire share of the capacity of Grand Gulf I would become a "participation unit," allocated to the operating companies pursuant to the formulae set forth in the System Agreement. In essence, this was achieved by determining each company's "responsibility" for the total capacity of its system—based upon its relative load—and requiring a company whose owned and purchased capacity was "short" of such responsibility to make payment to a company which was "long." The cost to a short company was based on the last installed plant of a company that was "long," called a participation unit.[53]

[53] *See* pp. 59–64, *supra*. To recapitulate, the method of allocation under the System Agreement was roughly as follows. Each company's relative load was determined by averaging its highest non-coincident hourly peaks on certain days. The resulting ratio of this calculation to the aggregate of such calculations for all operating companies on the

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Because the operating companies' load responsibilities would be expected to change with varying load growth, weather considerations, and other factors, and because their capacity ownership would change with the addition and retirement of generating units and purchases by off-system companies, it followed that the companies' allocation of Grand Gulf would also change. Grand Gulf was likely to be less attractive economically in early years—when the relatively undepreciated capital costs were amortized into the wholesale charges for Grand Gulf. Also, in later years Grand Gulf might be more attractive in comparison to plants built subsequently, if construction costs continued to escalate. (Of course, certain assumptions would have to have been made regarding the construction costs of both Grand Gulf and future plants, as well as alternate fuel costs, in order to conclude that Grand Gulf would have comparatively lower costs in the future.)

NOPSI's management testified that NOPSI wanted its share of Grand Gulf to be made definite because NOPSI expected to be "short" and a purchaser of Grand Gulf in the early (expensive) years, and a fixed share would assure that it could take advantage of the lower costs contemplated in later years. NOPSI also had a general interest in acquiring capacity that was not oil or gas fired in light of then-current conditions. (NOPSI Exh. 36 at 17–20.)

Turning to the magnitude of NOPSI's Grand Gulf share, it appears to have been determined as follows. First, AP&L was released of all of its responsibility to pay for Grand Gulf. According to Mr. Cain, because "AP&L already had in service or under

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Middle South System was called its "load responsibility." This ratio, when taken against the total system capacity, determined its "capability responsibility." The "capability responsibility" was then compared to the actual capability owed or under firm contract by the operating company. If the company was "short," it had an obligation to make up the difference by paying capacity-related costs to companies that were ["]long." These costs were based on those of "participation units"—the most recent major generating unit of a "long company." The entirety of MSE's ownership of Grand Gulf capability was to be allocated as a participation unit.

construction base load generating capacity consisting of 2 nuclear and 4 coal fired units, . . . and it was determined that AP&L did not need any additional base load capacity from Grand Gulf." (NOPSI Exh. 35 at 15.) However, it is evident that other approaches could have been pursued. For example, the costs of AP&L's facilities could have been shared by other operating companies, and AP&L could have taken a share of Grand Gulf. A somewhat different version of why AP&L was freed of its Grand Gulf responsibility was given by Mr. Edwin Lupberger, then Senior Vice-President and Chief Financial Officer of MSU, as follows: "Decreasing load growth and political and regulatory pressures have led AP&L to withdraw from the Grand Gulf project." (Tr. 528; CNO Exh. 6.) Similarly, in hearings before the LPSC, NOPSI's witness here, Mr. Louiselle, testified as follows:

> It was contented that AP&L already had either in-service or planned under construction a sufficient amount of base load capacity defined as: nuclear capacity, defined by the Middle South System as base load capacity. In other words, that's how they chose to define it and therefore did not need an additional increment of base load capacity from Grand Gulf. Of course, this reallocation took place *after* everyone realized what the cost of the unit was going to be. And it is my understanding *a certain amount of pressure was brought to bear on Middle South Utilities to get AP&L out of Grand Gulf.*

(CNO Exh. 33 at 856; emphasis added.)

Thereafter, according to NOPSI, studies were performed aimed at achieving an "equitable allocation of the Grand Gulf capacity and energy among the Middle South System operating companies." (NOPSI Exh. 36 at 39.) NOPSI further states that after "extensive discussion" and a "balancing of economic factors," and based on a number of objectives[54] a preliminary allo-

[54]Mr. Hurstell summarized these as follows:

1. To move each operating company toward having a relatively proportionate share of coal or nuclear base generating units.

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cation was arrived at in January 1980 that gave NOPSI 155 MW of Grand Gulf I and 210 MW of Grand Gulf II.[55]

However, still in January 1980, a different allocation was adopted. NOPSI states that in order to achieve a "minimization of fuel cost differences among the operating companies," additional calculations were made, pursuant to which NOPSI's Grand Gulf shares were substantially increased. (NOPSI Exh. 36 at 40-44.) However, the idea of basing this increase on the equalization of *fuel* costs, when the underlying *capital* costs of Grand Gulf were far more significant, has been seriously questioned in this proceeding and has never been satisfactorily explained by NOPSI. (CNO Exh. 38 at 40-1; CNO Exh. 29 at 188-89.) In any event, this resulted in NOPSI's taking 335 MW of Grand Gulf I and 335 MW of Grand Gulf II. (NOPSI Exh. 36 at 40-44.)

In January 1980, the chief executive officers of the operating companies approved the new allocation proposals in a signed memorandum. (NOPSI Exh. 36 at 44.) In July 1980, the companies signed a Memorandum of Understanding Re: Allocation of

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2. To assure the benefits of base generation's lower and more stable fuel prices to those operating companies which otherwise had inadequate base generation.

3. To reduce the disparity in the relative fuel cost of energy among the operating companies.

(NOPSI Exh. 36 at 39.)

[55]The allocation to all companies, including Grand Gulf II, was as follows:

	GG #1	GG #2	TOTAL
AP&L	—	—	—
ARK-MO	50 mw	70 mw	120 mw
LP&L	615 mw	420 mw	1035 mw
MP&L	305 mw	425 mw	730 mw
NOPSI	155 mw	210 mw	365 mw
	1125 mw		

(NOPSI Ex. 36 at 40.)

Capability of Grand Gulf I & II ("Memorandum of Understanding") embodying the allocation approved in January. (NOPSI Exh. 36, MLH-15, No. 7.)

Thereafter, the Municipal Electric Association of Mississippi ("MEAM") withdrew from its planned 2.48% participation in the Grand Gulf project. NOPSI's management seemed to have no awareness of or curiosity about the reasons why MEAM withdrew. (CNO Exh. 29 at 137.)

In a Reallocation Agreement of July 1981, the operating companies fixed the allocation of the Grand Gulf project in accordance with the prior Memorandum of Understanding, together with an increment resulting from MEAM's withdrawal. NOPSI's share was set at 29.8% each of Grand Gulf I and II. (NOPSI Exh. 36, MLH-15, No. 11.)

A series of new agreements and amendments to existing agreements followed the fixing of new allocations for Grand Gulf, of which several are described below.[56]

A 1982 System Agreement superseded the 1973 agreement. The new agreement changed the manner of computing each company's load responsibility such that it was computed on the basis of the company's 12 most recent monthly loads occurring at the time of the system's monthly peak. Moreover, under the new agreement the participation units were priced on the basis of the "intermediate generation units," defined as units fueled with natural gas or oil, instead of the most recently installed major units of the "long" companies. (NOPSI Exh. 36, MLH-15, No. 4.) The change in the System Agreement did not affect the allocation of Grand Gulf fixed for each operating company.

In addition, a Unit Power Sales Agreement ("UPSA") executed on June 10, 1982 provided that MSE would make available

[56]The Availability Agreement was amended on June 15, 1981 (NOPSI Ex. 36, MLH-15, No. 3(b)) and on June 28, 1984 (*Id.*, No. 3(c)).

to the operating companies, and the latter would take, all of MSE's capacity and energy from grand [*sic*] Gulf I and II, in accordance with their "entitlement percentages" (NOPSI's being 29.8%). It further set forth the terms, conditions and rates for MSE to charge and contained the recital that "AP&L is executing and delivering this Agreement solely for the purpose of consenting to the terms and provisions thereof and will have no rights or obligations hereunder." (NOPSI Exh. 36, MLH-15, No. 5.)

On June 15, 1981, the Power Purchase Advance Payment Agreement was executed and was later filed with the SEC pursuant to PUHCA. It provided that the four operating companies would make an aggregate advance payment of $12,500,000 per month, the share of each to be determined in accordance with its relative payment percentage specified in the Reallocation Agreement, if Grand Gulf I were not in commercial operation by December 31, 1983. Such payments were to be made until the earlier of December 31, 1985 or the date of the commencement of Grand Gulf I's commercial operations. (NOPSI Exh. 36, MLH-15, No. 9.)

L. *1980 Hearings Before The Council*

In May 1980, NOPSI filed an application with the Council seeking approval of a "capacity adjustment clause" as part of its retail rate schedule. This clause would have allowed NOPSI to pass through *automatically* in its retail rates the capacity-related costs of Grand Gulf once NOPSI began incurring charges for such costs. The hearings on this application marked the first time that the nature of NOPSI's obligations with respect to the Grand Gulf project was made known to the Council.[57]

[57]At the prudence hearing, NOPSI's management asserted that the Council had been "informed" about NOPSI's participation in the Grand Gulf project, even though it was conceded that the substance of

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At that time, NOPSI's management testified that the proposal would enable NOPSI to pass through the "benefits" of Grand Gulf I to the ratepayers of New Orleans. Mr. Hurstell presented a "study" which he had prepared that purported to show that New Orleans' ratepayers would benefit by $1.9 billion over the first nine years of the plant's operation. (NOPSI Exh. 36, MLH-12A.) However, the principal numbers and assumptions underlying the study were not prepared by Mr. Hurstell, but had been received from MSE, and Mr. Hurstell had not examined them critically.

During the hearing, Mr. Cain was pressed by several members of the Council regarding the propriety of NOPSI, with a total rate base of $210 million, having committed to a liability for Grand Gulf I—then optimistically estimated at $400 million—"without public consideration" and "without a Board meeting and without advice of counsel" and "without the approval of the Council and without the knowledge of the Council, which is the regulatory authority." 1980 Hearing at 554-45, 559-60, 575. In response, on two occasions Mr. Cain testified that if the Council were to find it inappropriate to participate in taking Grand Gulf power, the ratepayers of New Orleans would not have to bear its cost, since NOPSI would have the option of selling the capacity to other utilities. Specifically, Mr. Cain stated:

> If it is in the wisdom of this Council that it is not appropriate for New Orleans Public Service to participate in this agreement, which they will reflect on through either approval or disapproval of the capacity adjustment clause, through the

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the arrangement was not put before the Council until the 1980 hearings on the capacity adjustment clause. The record of the September 17, 1980 hearing indicates that NOPSI's president asserted only that the matter had come up in 1972 at a rate hearing in the context of the then-proposed Alligator Point plant, a time when the very different commitment made in 1974 to Grand Gulf had yet to be conceived. *In the Matter of NOPSI Rate Hearing—Public Hearing Electric and/or Gas Rates* transcript of September 17, 1980 (hereinafter "1980 Hearing") at 552-53.

> approval or disapproval of any rate relief we seek as per Grand Gulf, *then NOPSI has the option of selling the capacity and marketing it which, we think will be a very attractive commodity to other electric utilities* who will view this as very, cheap, reliable power for the future.

Id. at 547. (Emphasis added.) He further indicated that

> the Council has the option either to approve our participation in this project through the capacity adjustment clause, and if subsequently it does not then and we file a rate case and they say, 'No, we are not going to allow the recovery of any rates to recover those expenses,' then that's it. They have made the judgment that New Orleans Public Service should not participate in this unit. *And then we will have the option of selling this unit and our portion of it to some other buyer.*

Id. at 560-61. (Emphasis added.)

M. *Determinations By The FERC*

Two principal issues, *first,* the proper allocation of Grand Gulf as set out in the UPSA, and *second,* the sharing of generation costs as prescribed by the new 1982 System Agreement, were put before the FERC in two separate cases initiated by the filing of the two agreements.[58] Although the cases were tried separately and resulted in separate written opinions of administrative law judges presiding over each case,[59] the FERC jointly decided both cases in Opinion No. 234 (31 FERC ¶ 61,305), and in its opinion denying rehearing in Opinion No. 234-A (32 FERC ¶ 61,425). The FERC rejected the Grand Gulf allocation contained in the UPSA (Opinion No. 234, 31 FERC at 61,655), and it reduced substantially the share accepted by NOPSI's management, ordering the following Grand Gulf I allocation instead:

AL&L	36%
LP&L	14
MP&L	33
NOPSI	17
	100%

[58]The System Agreement case was Docket No. ER82-483-000; the USPA case was Docket No. ER82-616-000.

[59]*Middle South Energy, Inc.*, 26 FERC ¶ 63,044 (Liebman, J.) (1984); 30 FERC ¶ 63,030 (Head, J.) (1985).

(*Id.*)

NOPSI did not intervene as a party until after all the evidence had been taken in the two cases and the Administrative Law Judge had issued his initial decision. No NOPSI witness testified in the proceedings.

As indicated, in September 1980 the Council had been assured by NOPSI's president that the ratepayers of New Orleans were not bound to the costs of Grand Gulf I, and in 1981 the Council authorized a referendum which resulted in regulatory authority over NOPSI being transferred to LPSC. However, it became evident that the LPSC was not fully protecting New Orleans' interests in the FERC proceedings. The LPSC proposed an alternative allocation scheme that favored ratepayers outside New Orleans. Under the LPSC proposal, LP&L, the largest company on the system (approximately 44% of total system load), would take only 14% of the high-cost Grand Gulf 1 plant. In contrast, NOPSI, which accounted for only 9% of system load, would take 17% of the plant. In December 1982, New Orleans moved to intervene independently in the FERC proceedings, and it recommended that NOPSI receive no more than a 9% allocation. The LPSC's position with regard to the shares to be borne by LP&L and NOPSI, respectively, was ultimately adopted by the FERC.

The FERC held that it had jurisdiction over MSE's sales from Grand Gulf under Section 201 of the FPA, 16 U.S.C. § 824 (Op. 234-A 32 FERC at 61,946-61, 61,947), and authority to modify the allocation contracted for by NOPSI and the other Middle South companies under Sections 205 and 206 of the Act. (*Id.* at 61,949.)

The FERC adopted (Op. 234, 31 FERC at 61,655) the findings of Administrative Law Judge Liebman that the UPSA allocation would cause cost disparities among the companies on the system to the "serious detriment" of NOPSI's and other Louisiana and Mississippi ratepayers. Lieb. p. 27. *Middle South Energy, Inc.*, 26

FERC ¶ 63,044 (1984) (Initial Decision) at 65,104.[60] Thus, FERC held that the UPSA allocation, to which NOPSI's management had agreed, was unfair and unreasonable and ordered NOPSI's share reduced from 29.8% to 17%. (*Id.*)

Part of the basis on which the FERC undertook to alter the Grand Gulf allocation was that the Middle South companies were operating as "a highly coordinated integrated electric system . . . [which] results in planning, construction and operations which are conducted primarily for the system as a whole." Op. 234, 3 FERC at 61,645. The FERC took note of the joint planning operations of the companies, particularly through their mutual participation in the MSOC. It acknowledged testimony as to the role of individual companies, such as that provided by Mr. Trumps, also a witness for NOPSI here, as follows:

> Mr. Trumps testified that a function of the Operating Committee is to make general decisions as to the size, location, and timing of the units. The specifics as to size and location, he stated, are a function of the individual companies. He described the coordination process as one in which the individual companies participate in the development of the Operating Committee's consolidated power plans. These plans are submitted to and approved by the Chief Executive Officers of the operating companies, and the Boards of Directors of the individual companies approve their own construction projects and expenditures.

(*Id.* 61,647–61,648) citations omitted.

In Opinion No. 234-A, denying rehearing, the FERC rejected charges that it had treated the Middle South system as a "monolithic" entity. Op. 234-A, 32 FERC at 61,952. The FERC stated:

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[60]FERC Administrative Law Judge Head found that the UPSA allocation would result in NOPSI's having the highest costs on the system on a nine-year average basis between 1983 and 1992 inclusive, and that NOPSI would have the highest annual costs in seven of those nine years. *Middle South Energy Inc.*, 30 FERC ¶ 63,030 (1985) (Initial Decision) at 61,156-61-157. Over the nine years NOPSI's costs would average 61% above AP&L's costs, 36% above LP&L's and 6% above MP&L's. (*Id.*)

> [Opinion No. 234] repeatedly recognizes the individual operating companies are intimately involved in the planning stages of new generation units on the system. It further recognizes that the Operating Committee . . . makes major system decisions in the form of recommendations to the Chief Executive Officers who, in turn, vote on their recommendations, and that the individual companies make final specific decisions necessary to carry out the overall system plan.

Op. 234-A, 32 FERC at 61,953.

On the basis of the degree of system integration and planning, the history of its planning nuclear plants, and the specific history of the Grand Gulf project, the FERC determined that "some form of equalization of nuclear plant costs" was necessary to establish proper rates among the MSU operating companies. Op. 234, 31 FERC at 61,655. It thus adopted the findings of FERC Administrative Law Judge Liebman, "designed to equitably apportion" the total nuclear investment costs of the Middle South System (*id.*), which resulted in giving NOPSI a 17% allocation of Grand Gulf I costs.

The FERC's decision (recently reaffirmed by the agency on remand from the D.C. Circuit) is binding here, but it is not without its own contradictions. The FERC refused to equalize the costs of all generation on the system—notwithstanding that the FERC had rejected the argument that Grand Gulf was an "anomaly" in the regular planning and construction of generating facilities on the MSU system, and had concluded that "all generation additions, including Grand Gulf, have been planned in basically the same manner." (*Id.* at 61,651.) The FERC apparently viewed other cost differences as "relatively minor compared to the cost differences for nuclear generation" (*id.* at 61,656 n. 18) (which seems to ignore the significant cost differences noted earlier), and evidently believed that overall production cost equalization would be "a substantial change from the way costs were previously allocated" (*id.* at n. 19) (which, however, was also true of the FERC's own nuclear cost equalization formula).

The FERC confirmed that the result of its decision was "not equal rates for MSU affiliates" and it asserted that "the basis nature of regulatory control retained by the states under previous system agreements remains unchanged." Op. 234-A, 32 FERC at 61,952.

The FERC's decision established, by formula, a wholesale electric rate, allocating the cost of Grand Gulf I among NOPSI and its sister operating companies which must be paid to MSE. It did not purport to preempt matters within the Congressionally-preserved state domain of retail ratemaking. In Opinion 234-A, the FERC stated:

> [W]e concurred in [Judge Head's] discussion of the need to balance federal and state interests in exercising our jurisdiction. Furthermore, we think our opinion, taken as a whole, as well as Judge Head's discussion, which we adopted, clearly recognizes the role of the states in regulatory retail electric rates and the need to balance overlapping state and federal electric rate jurisdiction.

32 FERC ¶ 61,424 at 61,951.[61] As noted by Judge McNamara, a provision in those opinions requiring the states to pass through Grand Gulf costs is "conspicuous by its absence." *NOPSI I*, slip. op. at 8–9. He found:

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[61]In a subsequent docket concerning an amendment to MSE's tariff, the FERC explicitly rejected the suggestion that it rule on even a minor matter regarding retail ratemaking. *Middle South Energy, Inc.*, Order Accepting Revised Rate Schedule for Filing and Terminating Docket No. ER86-424-000 (June 30, 1986). The FERC held:

> In reference to the Louisiana Commissions's alternative request that MSE's wholesale customers be required to voluntarily pass through depreciation savings to retail customers regardless of existing rate settlement or rate orders, the request must be denied since such action would effectively require this Commission to intrude on matters within the province of retail ratemaking bodies. As noted above, it is our view that entities having jurisdiction over retail rates can take the appropriate action to require a pass-through of depreciation savings.

(*Id.* slip. op. p. 5.)

> [T]he FERC order merely prescribes interstate wholesale rates that NOPSI is obligated to pay in exchange for its share of Grand Gulf power. More importantly, there is no mandate in the FERC order for state regulatory authorities to pass through the expenses associated with NOPSI's interstate wholesale rates via an increase in intrastate rates.

(*Id.*)

It should be noted that the FERC's opinions do not address the manner, timing, or extent of recovery by operating companies of their Grand Gulf costs as retail rates. They do not address problems posed by the possibility of "rate shock." They do not address the need for a "phase-in" of rates. To the contrary, FERC Administrative Law Judge Liebman, confronted with a proposal for "levelization" (a type of phase-in), declined to exercise jurisdiction over the issue. Rather, he stated that the "design of local retail rates" was within the jurisdiction of the states; that the validity of phase-in plans would turn on its particular facts; and that advance "general pronouncements" on the subject were particularly inappropriate "in light of the clear bright line which the Federal Power Act sought to draw between Federal and state jurisdiction . . ." 26 FERC ¶ 63,044 at 65,148 (1984).

The FERC did not investigate or rule upon the prudence of the management of NOPSI or any of the individual companies in relation to the Grand Gulf plant; nor did the FERC indicate that it intended to preempt any inquiries into prudence at the local level. As previously indicated, one of the FERC's administrative law judges, confronted with suggestions made by Middle South attorneys that he should make implicit prudence findings, repeatedly stated "I'm not getting into that," and indicated that he could not prevent the issue from being litigated in a state forum. *Middle South Energy Inc.*, Docket No. ER82-616-000, Tr. at 228. Subsequently, the acting chairman of the FERC testified before Congress that:

> The Commission did not determine the prudence of the purchase of power by the Middle South Utilities from the Grand Gulf Nuclear Generating Station in Opinion Nos. 234 and 234-A.[62]

The FERC undertook no effort inquiry to determine what, if any, alternatives might have been available to an MSU operating company when, in light of new information and new events, the economic prospects for the Grand Gulf project changed.

N. *Grand Gulf Operations And Costs; Attempts To Dispose Of Grand Gulf*

In September 1974, the AEC issued construction permits for Grand Gulf Units 1 and 2, and full-scale construction began. (NOPSI Exh. 36, MLH Ex. 19-A, p. II-14.) In December 1974, Bechtel issued its first Definitive Cost Estimate and Schedule, which forecast completion of Grand Gulf I by January 1980 at a cost of $854 million. (*Id.*)

By the beginning of 1979, the projected cost of Grand Gulf I had risen sharply and its schedule had been significantly delayed. Bechtel's December 1978 Cost Forecast No. 5 projected a total cost of $1.310 billion, and its then-current schedule estimated completion by July 1981. (*Id.*, MLH Exh. 19-A, p. II-15.) It was against this background and after the Three Mile Island incident, that NOPSI, in January 1980, entered into an agreement which gave it a large fixed share of Grand Gulf I. (*Id.*, p. 40.)

Thereafter, in February 1980, Bechtel issued Cost Forecast No. 6 and Schedule Revision No. 3 which projected Grand Gulf I's completion by May 1982 at a cost of $1.773 billion. (*Id.*, MLH Exh. 19-A, p. II-16.) On July 21, 1980, the Memorandum of Understanding confirming NOPSI's large fixed share of each Grand Gulf unit was signed. (*Id.*, MLH Exh. 15, Item 7.)

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[62]Prepared Testimony of the FERC Before Subcommittee on Energy, Conservation and Power, of the House of Representatives Committee on Energy and Commerce, Hearings on Prudence Reviews (March 14, 1986).

Bechtel's Cost Forecast No. 7 and Schedule Revision No. 4 (forecasting completion by September 1982 for $2.176 billion) was issued in March 1981. (*Id.*, MLH Exh. 19-A, p. II-16.) In July 1981, NOPSI entered into the Reallocation Agreement, slightly increasing NOPSI's share to 29.8% of MSE's 90% share of both units. (*Id.*, MLH-15, Item 11.)

Just a half year later, in March 1982, MSS, as agent for all the operating companies, sent letters to 57 regional utilities offering to sell them all or part of the capacity and energy of Grand Gulf I. (NOPSI Exh, 36, MLH-21.) At that time, MSS projected the plant to be commercially operable by February 1, 1983 at a cost of $2000/kW and $1.6/kWh. (*Id.*) MSS' offer was not accepted by any utility. (NOPSI Exh. 36 at 57.)

Construction of Grand Gulf I was nearly complete by mid 1982. (NOPSI Exh. 36 at 25.) The plant received its low power operating license from the NRC in June of 1982, and commenced fuel loading in July. (*Id.*) Thereafter, the plant was continually subjected to increasing costs and schedule delays associated with regulatory compliance. (*Id.*) Bechtel's estimates increased from $2.888 billion in October 1982 to $3.046 billion in September 1983 and to $3.424 billion in May 1984. (NOPSI Exh. 36, MLH 19-A, at 16–17.) The NRC issued a full power operating license in July 1984. (NOPSI Exh. 36, MLH Exh. 19-A at II-17.) Grand Gulf I finally entered into commercial operation on July 1, 1985 at a cost in excess of $3.6 billion.

O. *NOPSI Files Application For Increased Rates*

On May 17, 1985, two days after regulatory authority was formally reinvested in the Council, NOPSI filed an application with the Council to increase its retail rates to recover the costs associated with its Grand Gulf I purchase. NOPSI's application constituted the largest and most complex rate increase proposal ever submitted to the Council. Rather than quantifying a specific

level of requested rate relief, NOPSI asked the Council to approve formulary rates which would permit its recovery of all costs billed by MSE each month.

At that time, NOPSI projected that its gross cost associated with a 17% allocation of Grand Gulf I would be approximately $160,000,000 annually. NOPSI projected that the Grand Gulf I purchase would reduce the operation of NOPSI's gas-fired plants and produce off-setting fuel savings of $27,000,000 annually. This resulted in a net Grand Gulf rate increase of $137,000,000 annually.

NOPSI subsequently increased its estimates. In its August 14, 1985 response to the Council's data requests, NOPSI indicated that its 17% allocation would amount to $179,000,000 and, after fuel savings of $27,000,000, would result in a rate increase of $152,000,000 annually (roughly 50% of NOPSI's prior annual revenue requirement of $300,000,000).

On May 23, 1985, the Council introduced Ordinance Calendar No. 12,585, establishing minimum standard requirements for rate applications. It also adopted Resolution R-85-296, giving notice of the introduction of the Standard Filing Requirements Ordinance and requesting that NOPSI immediately prepare materials necessary for expeditious consideration of its application.

Beginning June 4, 1985, NOPSI submitted to the Council a series of requests to modify or waive the Standard Filing Requirements. The Council met informally with NOPSI to discuss the filing requirements, and the Council introduced a resolution to propose certain changes. On July 11, 1985, at a hearing held to adopt the filing requirements, NOPSI's attorney requested a delay in adoption to afford NOPSI more time for consideration. On August 8, 1985, the Council adopted Ordinance Calendar No. 12,626, fixing standard filing requirements. NOPSI was requested to refile its application within 30 days.

NOPSI made a partial submission of its refiled application on September 30, 1985, two weeks overdue. On October 11, 1985, NOPSI finally completed its filing.

On July 17, 1985, after public hearing and review of its technical consultant's report, the Council adopted Resolution R-85-356A, which authorized NOPSI to issue securities in the amount of $60,000,000. The Council, on its own motion, fixed a date for a public hearing on interim rate relief. Resolution R-85-423.

At a public hearing on July 25, 1985, the Council noticed that no formal request for interim rate relief had been filed by NOPSI. By Motion M-85-326 the Council, in order to prevent any undue hardship and prejudice to the company, invited NOPSI to make an abbreviated formal request for interim rate relief, waived the standard filing requirements therefor, and pledged expedited treatment. Rather than requesting interim relief, NOPSI filed its lawsuit (*NOPSI I*) in federal district court on August 1, 1985. The district court denied NOPSI's motion for preliminary relief by oral order of August 10, 1985 and dismissed NOPSI's complaint by order of September 16, 1985 on the grounds previously indicated.

Pursuant to the district court's order of August 10, 1985, NOPSI filed a formal application for emergency relief on August 19, 1985. After hearings on August 22, 1985 and September 5, 1985, the Council issued Resolution R-85-526, granting NOPSI $28,033,000 interim rate relief.

NOPSI filed an application on September 26, 1985, seeking certain changes in and clarifications of the interim relief order. After public hearings the Council, on October 10, 1985, adopted Resolution R-85-635, which amended and clarified Resolution R-85-526 and granted NOPSI further interim relief. Resolution R-85-635 provided, *inter alia*, that the deferral period for NOPSI's uncollected expenses during the interim rate relief period could commence at the same time that NOPSI's Grand Gulf purchases began, *i.e.*, July 1, 1985. In addition, the Resolution provided that the Council could reconsider the matter of interim relief should future circumstances so merit.

On October 17, 1985, six days after NOPSI completed submission of its rate application in compliance with the Standard Filing Requirements, the Council adopted Resolution R-85-636 ("Prudence Resolution") initiating this investigation of NOPSI's prudence with respect to its purchase of power and energy from the Grand Gulf plant. The Council defined the scope of its inquiry as follows:

> The Council's investigation shall include inquiry into all aspects of NOPSI's prudence regarding its decision to enter into its arrangements to purchase a portion of Grand Gulf I for the purpose of determining what portion, if any, of NOPSI's Grand Gulf I expense shall be assumed by its shareholders, rather than passed through to its retail ratepayers. The Council shall inquire into, *inter alia*, NOPSI's justification for its Grand Gulf I purchase, its consideration of alternatives to Grand Gulf I, the nature of its liability to MSE and MSE's creditors and its efforts to minimize its total cost exposure for the purchase. The Council shall also investigate NOPSI's need for Grand Gulf I capacity, NOPSI's decision to mothball and/or decommission existing generating facilities within Orleans parish, the impact of NOPSI's purchase of Grand Gulf I power on its existing generating system, and its impact on its other power supply opportunities. The Council will not seek to invalidate any of the agreements surrounding Grand Gulf I or to order NOPSI to pay MSE a rate other than that approved by the FERC.

Resolution R-85-636 at 4.

The Prudence Resolution requested NOPSI to respond to a series of questions related to its prudence within 30 days, or by November 18, 1985. NOPSI did not submit a response or come before the Council to discuss its concerns about the Prudence Resolution. Instead, it initiated a second lawsuit (*NOPSI II*) in federal district court against the Council on November 14, 1985. This lawsuit was dismissed on December 11, 1985 on substantially the same grounds as *NOPSI I*. Five days later, and almost a month overdue, NOPSI submitted testimony and exhibits in response to the Prudence Resolution.

On February 20, 1986, the Council conducted a public hearing on a settlement proposal submitted by NOPSI on February 5, 1986. Thereafter, the Council and NOPSI conducted extensive negotiations resulting in a settlement of the rate case, previously described.

Meanwhile, testimony on the rate aspects of the settlement proposal was taken. Direct testimony and exhibits of consultants, testifying on behalf of the Council, were submitted on February 20, 1986. NOPSI filed its rebuttal testimony six days later. Hearings were held before John B. Farmakides, the Hearing Examiner appointed by the Council, on March 4, 5, and 7, 1986. The hearings were adjourned to reconvene at a later date to begin the taking of testimony on the prudence inquiry.

The course of the prudence proceedings and other matters relating to the litigation and attendant appeals have been previously set forth.

PART C. PRUDENCE ANALYSIS

VI. *ANALYSIS OF PRUDENCE ISSUES*

We now turn to the central issue of how NOPSI's officers and directors discharged their responsibility to manage the company prudently in relation to the Grand Gulf project. The circumstances recited in the preceding section lead us naturally to focus on three critical areas: (A) NOPSI's initial and binding commitment to Grand Gulf, in which it undertook an indeterminate liability for the project; (B) The question of diligence of NOPSI's management in monitoring conditions and information regarding the project and NOPSI's options as the Grand Gulf project went forward; and (C) NOPSI's agreeing to a large fixed commitment to Grand Gulf and its failure to lessen, or hedge against, the risks of its Grand Gulf commitment and secure alternative sources of power, particularly coal-fired, during the "dynamic" period of 1979-1980.

A. *NOPSI's 1974 Indeterminate Commitment to Grand Gulf*

In 1974, NOPSI undertook a binding but open-ended contractual commitment to Grand Gulf, virtually indeterminate in terms of the monetary exposure it could involve. At issue here is not whether it was reasonable for NOPSI in 1974 to seek an appropriate amount of additional capacity from one or more sources. Rather, we believe that the kind of commitment undertaken here by NOPSI to a single nuclear project cannot reasonably be deemed to have been prudent utility management.

Under the terms of the Availability Agreement, NOPSI was obligated to pay for Grand Gulf in accordance with the allocation formula set forth in the System Agreement. All of the capacity of Grand Gulf owned by MSE was to be a "participation unit" and thus subject to the allocation formula. Because NOPSI had no other planned capacity additions, it would, based on any plausible forecast, be "short" and obligated to take a "substantial amount" of Grand Gulf—particularly in the early years, when it would be "relatively expensive." (NOPSI Exh. 36 at 18.) Beyond this, however, NOPSI did not know how much it would be required to take or what the price would be. This indeterminate obligation would, moreover, mature at a time sufficiently far in the future that the circumstances and NOPSI's exposure could not be accurately forecasted.

NOPSI's Senior Vice President, Mr. Hurstell, testified that in 1974, the magnitude of NOPSI's commitment to Grand Gulf could not be quantified in megawatts (Tr. 591) or in dollars (*id.*) or as a percentage of the plant (Tr. 599), and that NOPSI's monetary exposure was undeterminable:

> Q. Could you have ascertained what your monetary exposure was when you signed up, when NOPSI signed up for the plant in 1974?
>
> A. No.

(*Id.*) He went on to capsulize NOPSI's position in 1974 in the following testimony:

Q. So there was no question in your mind in 1974 that NOPSI was going to take and pay for some of Grand Gulf?

A. That's correct.

Q. But you didn't know how much?

A. Didn't know how much.

(Tr. 615.)

NOPSI's management took on this indeterminate obligation despite its recognition, recorded in NOPSI's board minutes in September 1972, that "steeply rising costs of nuclear plants have thrown a cloud on their possible future use by the Middle South System." (CNO Exh. 42.) The Council's expert consultant, Mr. Jack Lundberg, characterized NOPSI's situation as follows:

> By signing the 1974 Availability Agreement . . . NOPSI accepted a future fully exposed to 'steeply rising costs' under conditions where such costs were largely beyond its direct control. The Availability Agreement set no limits on NOPSI's exposure.

(CNO Exh. 31 at 13.)

Mr. Lundberg pointed out that "a major purpose of any power supply contract should be to clearly define and set limits on responsibilities and exposure to areas of risk." (CNO Exh. 31 at 13.) In contrast, he noted, the agreement here created risk without limits and definition. It did not define the percentage of the plant to which NOPSI was obligated. NOPSI's obligation could vary over time by 300 percent—that is, from 100 to 300 megawatts. In addition, the ultimate cost of the plant itself was not only difficult to forecast, but beyond NOPSI's control, because it did not own the plant and had, at best, an extremely attenuated position in the management of the project.

The risk posed by the indeterminate nature of NOPSI's obligation was made more serious by the stringency of other terms of NOPSI's obligation. Mr Lundberg noted that under the Availability Agreement,

- NOPSI was fully obligated to pay its share under the System Agreement as of the date Grand Gulf I was 'deemed to be in operation,' whether the plant was in operation or not.
- Similarly, NOPSI was obligated to pay its share of expenses that might be incurred in a "permanent shutdown" of Grand Gulf I including 'perpetual maintenance and surveillance.'
- NOPSI 'irrevocably waived' its rights to raise MSE's legal remedies to bar a suit for specific performance of the Agreement.

He concluded, "In view of the stringency of NOPSI's obligations under the Availability Agreement, it was *very imprudent* to enter into an agreement with no fixed allocation of capacity to be purchased." (CNO Exh. 31 at 14, emphasis added.)

Both the circumstances surrounding and the implications of NOPSI's 1974 commitment to Grand Gulf underscore its inconsistency with prudent management. As previously indicated, NOPSI's management was already aware of "steeply rising nuclear plant costs." The rise in such costs was apparent, both absolutely and relatively. Mr. Lundberg testified that while both coal and nuclear projects were faced with new regulations (environmental in the case of coal, and safety-related in the case of nuclear), "the cost of nuclear facilities was rising more rapidly than the cost of coal and there was good reason to believe they would continue to do so." (CNO Exh. 31 at 12.)

Moreover, nuclear projects took longer to complete and were thus subject to less cost predictability and greater exposure to interim changes. In the early 1970's nuclear projects were viewed as requiring a minimum of ten years from conception to completion, while coal projects required from two to four years less time. (*Id.* at 11–12.) In addition, because of safety concerns, nuclear projects "had to be viewed as far more exposed to potential shutdowns due to changing standards and regulations." (*Id.* at 12.)

Mr. Komanoff summarized these circumstances in the following testimony:

> Nuclear power was beset with technical problems and public opposition in 1974. These had already begun to be translated into marked increases in reactor costs and schedules. While other electric generation sources also suffered from disadvantages as to cost, reliability and feasibility, nuclear ventures such as Grand Gulf were probably inherently more risky than alternatives, in 1974. NOPSI's acceptance of an unspecified and ineffectively limited share of Grand Gulf in these circumstances was imprudent.

(CNO Exh. 38 at 26.)

Moreover, NOPSI was the smallest of the operating companies, with a limited service area. Because (as will be discussed hereafter) the magnitude of NOPSI's ultimate Grand Gulf obligation did not depend merely upon its own load growth, but on factors beyond its control, NOPSI's size made it particularly vulnerable to adverse effects if the Grand Gulf project turned out to be uneconomic, as it ultimately did.

NOPSI's indeterminate exposure had obvious debilitating effects. It limited other avenues for diversification. There was no sound reason, other than the burden of its indeterminate commitment to Grand Gulf, for NOPSI not to have sought participation in AP&L's White Bluff and ISES coal projects (CNO Exh. 28 at 112) in the manner, for example, that MP&L did as previously described. Although NOPSI claimed to have plans to take 10 percent of the Wilton coal project in the late 1980's, this would have amounted to only 80 MW, was far in the future, and was at an unknown cost. Moreover, the plans for the Wilton project were themselves subject to derailment if Grand Gulf proved uneconomic, and the project in fact has never materialized.

The unquantified nature of NOPSI's obligation impeded, from the outset, not only NOPSI's ability to make other plans but also its ability to protect itself if the project went sour. The unspecified

amount of the commitment would have made it more difficult for NOPSI to structure a sale of its Grand Gulf power if circumstances merited its doing so. In fact, NOPSI relied upon the indeterminate size of its own allocation to argue against the testimony here that NOPSI should have sold substantially all of its Grand Gulf position in 1979 and 1980. (NOPSI Exh. 43 at 9.) That argument, however, merely highlights the imprudence of NOPSI's management in accepting indeterminate liabilities at the outset of the Grand Gulf project.

NOPSI's expert witness Mr. McWhinney acknowledged the "indeterminacy of the allocation" undertaken by NOPSI, but sought to defend it on the basis that NOPSI's share of Grand Gulf would increase in relation to NOPSI's load growth, and decrease if it had lower growth. It was, he thought, "preferable to a fixed share." (NOPSI Exh. 53 at 25-26.) However, on cross-examination, Mr. McWhinney conceded that NOPSI's Grand Gulf responsibility would change, not merely in relation to its own load growth, but in relation to other factors not involving NOPSI's growth or within NOPSI's control. For example, its share would be related to the low or high load growth of other companies; the retirement or abandonment of other generation resources on the system; and any changes in construction plans of new units. (Tr. 1741-42.) At the conclusion of this line of inquiry, Mr. McWhinney conceded as follows:

> Q. . . . So NOPSI's future obligation to take from Grand Gulf wasn't related solely to NOPSI's own load growth, isn't that right?
>
> A. That's correct.

(*Id.*)

There were clearly alternatives that NOPSI could have pursued, but there was no evidence that it did so. For example, it would have been rewarding to have found evidence that NOPSI's management had insisted from the outset that NOPSI should not have to accept more than 9 percent of the ultimate cost responsi-

bility—an amount related to its relative size and relative ability to bear risk (CNO Exh. 38 at 13) for Grand Gulf. Moreover, had limits on NOPSI's commitment been imposed at the *outset* of the project, and thereafter formed part of the factual record before the FERC, it is highly doubtful that the FERC would have felt free to allocate a large portion of Grand Gulf I to NOPSI.

NOPSI had other generation options for meeting its forecasted load so that it was not required to commit so extensively to a single nuclear project. Mr. Lundberg testified that NOPSI should have planned to diversify its additional resources; that it should have limited its Grand Gulf commitment to an amount on the order of 100 MW and satisfied the balance of its capacity needs through other projects on the system—pursuing a mix of fuel and project sources; and that it should have sought participation in one or more of AP&L's four proposed coal-fired facilities. (CNO Exh. 31 at 16-18.) He cited, as a contrasting example, the municipal utility operations of the City of Jonesboro, Arkansas which, during the same time period, reviewed more than 50 different power resources and ultimately acquired a 5% share of AP&L's White Bluff and ISES units. (CNO Exh. 31 at 16-17; NOPSI Exh. 38 at 87.) NOPSI apparently made no such investigation and did not explore participation in such units.

Despite the enormity of its 1974 commitment and its recognition that Grand Gulf was an unprecedented and "major" commitment of the company, NOPSI did not inform the City Council of its obligations under the Availability Agreement until 1980. (CNO Exh. 31 at 9.) Had NOPSI's management for any reason, whether or not justifiable, felt timorous about protecting the welfare of NOPSI's ratepayers because of pressure from MSU or others, that circumstance could have been overcome by a timely intercession of the Council, which was empowered to regulate NOPSI. The secretiveness of NOPSI's management was itself imprudent and compounded the deficiencies we find in its actions and inactions.

Despite NOPSI's serious imprudence in this area, other events which have taken place at the federal "wholesale" level have limited our remedial powers. In its Opinions 234 and 234A, the FERC has set NOPSI's share at 17 percent of Grand Gulf I. We interpret existing law as requiring that the federally-determined allocation of Grand Gulf I costs, resulting in a wholesale rate, be binding on NOPSI and upon the Council. We therefore base no rate remedy upon the imprudence of NOPSI's management in accepting an indeterminate share in 1974 and in creating circumstances which left NOPSI subject to a formulary allocation that is nearly twice its relative size in the system. However, NOPSI's ratepayers should have no doubt that, in our opinion, their interests were neither well considered nor well served by NOPSI's management in the critical undertakings that bound NOPSI to the Grand Gulf project in 1974.

B. *NOPSI Failed to Maintain Prudent Oversight Of Its Grand Gulf Obligations*

As a public utility committed to purchase a substantial portion of the power of the Grand Gulf project, NOPSI should have had great concern with the progress and cost of the project. (CNO Exh. 28 at 37; CNO Exh. 29 at 112.)[63] NOPSI concedes that its commitment to Grand Gulf was a "major commitment." (Tr. 622.) It was certain that NOPSI would have an obligation to take and pay for some amount of Grand Gulf without any set limits on the price it would pay. Therefore, it had an obligation to monitor that exposure carefully during the construction of the project. In this regard, the conduct of NOPSI's management was plainly inadequate.

[63]There is, however, good reason to doubt that the incentives necessary for cost control were present here. It was expected that the costs of Grand Gulf would be passed on from Bechtel, to MSE, to NOPSI, and then to ratepayers—untempered by competition at any level. It is questionable whether this pass-through system is likely to generate the same incentives to contain and monitor costs as would be present in an unprotected commercial environment (Tr. 651-2; CNO Ex. 29 at 113), notwithstanding the prospect of subsequent administrative review.

In 1974 NOPSI had approximately 30–40 employees comprising its upper management and associated staff (Tr. 622), a number which had grown to approximately 90 by the date of the hearing (Tr. 594). There were, nevertheless, no organized systems or procedures for maintaining oversight of NOPSI's Grand Gulf commitment. Despite the fact that information with respect to Grand Gulf came in from a variety of formal and informal sources, there was no central or even regular procedure for handling information that was received. (*Id.*, CNO Exh. 29 at 72; CNO Exh. 28 at 34-35.) Moreover, there was no committee or other instrumentality to deal in a coordinated way that information, nor was there any committee established within NOPSI to assess developments at the project from the perspective of NOPSI's interests. (Exh. 29 at 5[illegible].)

Although the cost forecasts for Grand Gulf showed an unremitting increase (CNO Exh. 28 at 64), there was apparently no one at NOPSI responsible for critical review and analyses of the cost estimates. (CNO Exh. 28 at 70.) There was no evidence that NOPSI questioned any of the assumptions that underlay, or the components making up, the cost estimates. NOPSI's president, Mr. Cain, testified:

> Q. As a buyer of the service or product that was being offered, and being the recipient of information as to how much you, as a buyer, would have to pay, you had some concern, I take it, about making sure that the cost estimates were accurate, or responsible; isn't that right?
>
> A. Yes, as part of an overall electric utility holding company which was responsible for the development of the plans for the construction of the plant, the justification for the need for the plant, and other aspects as part of that system. We were a buyer.
>
> Q. You were a buyer, and you had that concern?
>
> A. Yes.

> Q. So, as these cost estimates came in, did you or anybody else acting under your direction ask about the assumptions that underlie those estimates, and the components of the estimates?
>
> A. We could have, sir. I don't know.
>
> Q. Do you recall a discussion where that took place?
>
> A. No, sir.
>
> Q. Did you ever direct any employee of NOPSI, officially or otherwise, to contact anybody with respect to a particular cost estimate?
>
> A. No, sir, not that I can recall. I could well have, but I don't recall an instance.

(CNO Exh. 28 at 40-41.)

There was no coordinated review of cost increases. Apparently, Mr. Hurstell was the only person on the routing list for the cost forecasts which Mr. Cain received. (CNO Exh. 29 at 92-93.) As far as Mr. Hurstell knew, there was no one at NOPSI who sought to determine whether the cost forecasting was reliable. Instead, NOPSI relied entirely upon MSE and Bechtel. (Tr. 650.) This was so despite the fact that Bechtel had an obvious self interest in the continuation of the project (CNO Exh. 28 at 66-67), and was engaged under a contract which allowed it to pass through its costs (Tr. 651).

Despite NOPSI's assumption that it could rely entirely upon MSE, Mr. Cain testified that he never participated in any discussions at the MSE board meetings, or elsewhere, dealing with the reliability of Bechtel's estimates (CNO Exh. 28 at 70) and was not aware of anybody within MSE engaged in a critical analysis of Bechtel's forecasts and their underlying assumptions. (*Id.* at 71.) (MSE itself was largely a shell organization, having a staff of no more than two to three persons and no office space of its own. Those who served in elected capacities were employees of other companies in the Middle South System.) (CNO Exh. 28 at 91-93.)

After the Three Mile Island incident occurred in March 1979 —a critical event for nuclear reactor construction and costs— NOPSI failed to act prudently to assess the evolving circumstances and protect its interests. Mr. Cain testified that there were no meetings held at NOPSI with regard to the impact of the Three Mile Island incident. (CNO Exh. 71-72.) Mr. Cain never called for a cost estimate to assess any possible impact of the Three Mile Island incident on the Grand Gulf project and NOPSI's interests. (*Id*. at 74.) Instead, in the wake of the Three Mile Island incident, and despite the absence of a revised cost forecast being issued in 1979, NOPSI, in January 1980, acceded to a share of Grand Gulf that was more than three times larger than its relative size in the Middle South system.

The next cost forecast was issued in February 1980, but Mr. Cain was not aware of why it had taken so long for a new cost estimate to be prepared. He did not know whether the new 1980 forecast purported to reflect any increased costs threatened by the Three Mile Island incident, and he did not recall questioning at the time whether the forecast did so. (*Id*. at 74-75.) While Mr. Cain assumed that someone in the Middle South System was responsible for tracking the cost of finished nuclear plants during this period of time, he could not recall who had that responsibility. (*Id*.)

Mr. Hurstell, who was the person principally relied upon by Mr. Cain with respect to Grand Gulf (CNO Exh. 28 at 12), testified that during the entirety of the year 1979, NOPSI "did not have any particular meetings" with regard to the possible impact of Three Mile Island. (CNO Exh. 29 at 84-85.) Mr. Hurstell had no appreciation that Three Mile Island might result in substantially increased costs. He testified,

> Q. Your testimony is that in the year 1979 you had no appreciation that Three Mile Island might result in substantially increased costs with respect to Grand Gulf?
>
> A. I had no idea, no, sir.

(Tr. at 668.) Moreover, it is Mr. Hurstell's position that Three Mile Island was blown up by the press. He testified:

> Q. Are you saying a disproportionate amount of attention was focused on Three Mile Island by the press?
>
> A. In retrospect I would say, perhaps.

(Tr. 789.)

Throughout these events, it appears that NOPSI's own board of directors was minimally involved and extremely passive. While Mr. Cain testified that NOPSI's board "may have been informed as to what the latest estimate of costs would be" (CNO Exh. 28 at 97), he testified that no discussions emanated from members of the board with regard to any position that NOPSI should take or attempt to take with respect to its participation in the Grand Gulf project. (*Id*.) He testified also that the board did not ask for any information other than what had been provided to them and the [*sic*] there were no questions raised by them as to the implication of Grand Gulf costs for NOPSI's ratepayers. (*Id*. 97-98.) The board never raised the issue of the reliability of cost estimates that they were receiving. (CNO Exh. 19 at 61-62.) Moreover, several directors recalled no discussion of the impact of the Three Mile Island incident on the Grand Gulf project or NOPSI's obligation therefore [*sic*]. (CNO Exh. 17 at 19-20; CNO Exh. 27 at 39.) NOPSI's board was not consulted in advance of NOPSI's entering into the key agreements effecting the major reallocation of Grand Gulf obligations among the operating companies in 1980. Rather, the board merely ratified the documents afterwards. (CNO Exh. 28 at 119-120.)

NOPSI never sought to determine the impact of Grand Gulf on the ratepayers of New Orleans and never sought of bring the issue of ratepayer impact to the attention of the MSE board. (CNO Exh. 28 at 47.) NOPSI's management held no meetings to discuss the subject of the cost impact of Grand Gulf on NOPSI's retail customers. (*Id*. at 54.) NOPSI put no one in charge of dealing with its relationship with the ratepayers of New Orleans,

and Grand Gulf apparently became a subject of concern only just prior to its commercialization.

In relevant areas, such as the possible purchase of coal fired power as an alternative, NOPSI was passive, so that if no "offers" were made to it by others, NOPSI assumed that no opportunity existed. During the discussions leading up to NOPSI's taking a large fixed share of Grand Gulf in 1979-1980, NOPSI apparently made no proposal of its own. (Tr. 461-62.) Indeed, its president had not even determined if NOPSI could object to a proposal put "forward or adopted by the system." (Tr. 464-465.)

Throughout the presentation of evidence regarding these events, there has been a curious and incredible lack of relevant documentation. Despite the fact that NOPSI's president, Mr. Cain, testified that he made and passed around notes and sheets of information regarding Grand Gulf, none whatever were produced by NOPSI in response to the Council's discovery requests. Although Mr. Cain relied primarily upon Mr. Hurstell in discussing matters relating to Grand Gulf (CNO Exh. 28 at 12), Mr. Hurstell claims to have prepared no memoranda regarding Grand Gulf during the many years of the project, with the exception of the "study" prepared in 1980 (MLH Exh. 12). That "study" utilized cost figures for Grand Gulf supplied by an unspecified source at MSE and was designed to persuade the Council to authorize an automatic pass-through of Grand Gulf capacity costs. (Tr. at 693-694). Moreover, although NOPSI's management made vague references here to supposed MSE evaluations of the economics of Grand Gulf and the impact of Three Mile Island, there were virtually no memoranda produced evidencing an exploration of these issues.

It is difficult to avoid reaching the regrettable conclusion here that document production by NOPSI in this proceeding bears the indicia of expurgation and selective production. The absence of such materials, or the failure to produce them, is highly disturbing.

To recapitulate, there is no indication in the record here that NOPSI organized itself responsibly to deal with information and events pertaining to the Grand Gulf project. Its own board was passive and was consulted on key events after the fact. It never sought to assess the impact of Grand Gulf on NOPSI's retail ratepayers; never sought aggressively to pursue options that might have been available to the company; never questioned cost assumptions; was unconscious as to the potential impact of Three Mile Island; did not advance positions favorable to NOPSI in MSE board meetings or other "system" organizations; and ultimately, it failed to protect its own ratepayers by accepting a share of Grand Gulf which one of its own experts has flatly testified was imprudent (CNO Exh. 33 at 853-54) and was found to be unreasonable by the FERC.

C. *NOPSI Failed to take Prudent Actions in the Critical 1979-1980 Time Frame.*

Summary of Analysis

1. *During 1979, the Situation Changed Radically.*

Problems that affected the rationale underlying, and economics of, NOPSI's relationship to Grand Gulf had been growing throughout the mid-1970's. By the end of 1976, NOPSI had made a substantial downward adjustment in its forecasted load. Concurrently, the forecasted costs of Grand Gulf had risen to almost 70% above original estimates. (CNO Exh. 31 at 21.) The need to meet load growth had been the principal rationale for Grand Gulf. While the FERC has suggested that the rationale shifted to one of fuel diversification as load forecasts fell, the increasing cost burden of the Grand Gulf project in fact threatened such diversification.

By end of 1978, projected completion costs of Grand Gulf I were $1,048 per KW, more than *double* original estimates. Increasing nuclear plant costs were not, as NOPSI's management

professed to believe, merely the result of inflation. Rather, knowledgeable sources in the industry were reporting that regulatory design and safety requirements—characterized by the industry itself as "even-expanding" [*sic*]—were greatly increasing the duration and cost of nuclear plant construction. (CNO Exh. 38 at 58.) As an example, one study stated "The most significant effect on nuclear plant costs has been compliance with revisions to the NRC regulations and the 100 plus regulatory guides." (Ebasco Services, "Dramatic Changes in the Costs of Nuclear and Fossil-Fueled Plants," Sept. 1978 pp. 6-7, CNO Exh. 38 at 58.)

In addition, important new analyses of nuclear plant cost trends conducted at MIT, the Rand Corporation and by Mr. Komanoff undercut the conventional industry method of estimating nuclear plant costs and showed that real costs were rising at much higher rates. (*Id*. at 48; Tr. 1823-1825.)

On top of these trends was the Three Mile Island incident in March 1979. The incident threatened major regulatory consequences for nuclear plants, which in turn meant higher nuclear plant costs.

According to Mr. Hurstell, the 1979-80 period was a "very dynamic time" (CNO Exh. 28 at 60), but he seemed inexplicably blind to the skyrocketing costs of nuclear plants, mentioning only other factors—*i.e.*, the curtailment of natural gas, the questionable availability of oil, the Fuel Use Act, and the increasing cost of oil and gas. (*Id*. at 75-79.) These factors, it should be noted, were neutral on the choice between coal and nuclear that confronted, or should have confronted, NOPSI's management. (Tr. 677.)

2. *What NOPSI Did and Failed to Do.*

It is useful to evaluate the corporate "state of mind" with which NOPSI approached the significant events of 1979-80. As

indicated in previous sections, NOPSI (a) never questioned cost estimates; (b) never questioned assumptions underlying cost estimates; (c) did not know if the cost estimates it received after March 1979 included a factor reflecting potential cost increases attributable to Three Mile Island (CNO Exh. 28 at 164); (d) never sought a cost estimate to reflect Three Mile Island; (e) never held a meeting to discuss potential impact of Three Mile Island; (f) relied on the "system" to make cost estimates and to deal with Three Mile Island, but could not point to any particular agenda item at MSE meetings that dealt with either issue; and (g) never sought to determine the impact of Grand Gulf on NOPSI's ratepayers.

NOPSI, and apparently MSE as well, was either oblivious to, or intentionally ignored, statistical analyses showing major upward cost trends in nuclear plants even before the Three Mile Island incident. (Tr. 761.) Moreover, NOPSI's management apparently believed that the Three Mile Island incident was overblown and had "no idea" that it might result in substantially increased costs. (Tr. 668.)

There is no evidence that NOPSI even explored any alternatives. (CNO Exh. 31 at 21-22.) Instead, in January 1980, within 9 months after Three Mile Island, NOPSI acquired a large fixed share (about 29.8%) of Grand Gulf, an unfinished nuclear plant. (Tr. 686.)

Instead of critically examining its circumstances, NOPSI's objective was to put the best face on its Grand Gulf commitment in order to secure an advance, automatic pass-through of Grand Gulf costs to its ratepayers before the true costs were known. In 1980, with costs continuing to rise, NOPSI filed an application with the Council seeking approval of a "capacity adjustment clause" that would have enabled it to pass through Grand Gulf costs in retail rates automatically. (Tr. 692-4.) At that time it presented a "study" prepared by Mr. Hurstell (NOPSI Exh. 36, MLH 12A, 12B) that purported to show $1.8 billion in benefits

to the ratepayers from Grand Gulf over 12 years (Tr. 682-3). Its purpose was to persuade the Council that "even with this increased cost of Grand Gulf that it would be economical." (CNO Exh. 29 at 80.)

NOPSI's management did not know whether or how Three Mile Island effects were reflected in the cost estimates (*Id.* 161-164), but relied entirely on MSE to supply cost information. NOPSI engaged in no critical examination of the information it received. (*Id.* Tr. 683; 164). Moreover, the key chart in Mr. Hurstell's "study" presented to the Council in 1980 was itself misleading. The columns on the chart were labeled so as to compared "fossil only" generation to a "fossil and nuclear" mix. Although the term "fossil" normally includes coal-fired power (Tr. 689), in Mr. Hurstell's chart, substantially no coal-fired power was included. (Tr. 688-689.) Thus, the chart could easily have been misunderstood as showing that nuclear power costs had been analyzed and compared to coal-fired alternatives, with favorable results, but this was not the case.

Set on justifying Grand Gulf, NOPSI's uncritical commitment undoubtedly impaired any disposition to explore opportunities to diversify (Tr. 679). Under its own plans as they stood in 1980, NOPSI was to acquire only 80 megawatts of coal, almost a decade later (*Id*; CNO Exh. 33 at 859)—assuming, of course, that NOPSI or others had the financial resources to build new coal plants at that time. However, Grand Gulf I was to exhaust those resources.

3. *What NOPSI Should Have Done.*

In 1979, and following the Three Mile Island incident at the latest, NOPSI should have engaged in a major reevaluation of its power supply commitments (CNO Exh. 38 at 18). NOPSI's own expert witness, Mr. McWhinney, testified that NOPSI should have "used all information that was available" (Tr. 1801) and that in reaching a decision prudently, "all available, relevant,

meaningful information should be brought to bear" (Tr. 1877). NOPSI failed to inform itself adequately, and was wholly unaware of important materials bearing upon nuclear plant costs directly relevant to its Grand Gulf commitment.

Had NOPSI's management undertaken to become adequately informed, it would have concluded, at the least, that Grand Gulf posed a major risk to it and was likely to be uneconomic and result in a major liability. Mr. Komanoff's testimony, which we find credible, is to the effect that such a review, if undertaken in 1979, would have shown that NOPSI's Grand Gulf I commitment could cost NOPSI an excess lifetime cost of $320 million over a coal-fired alternative, even using certain "conservatisms" favorable to NOPSI's position on Grand Gulf. (CNO Exh. 38 at 9.)

NOPSI should have attempted to minimize these Grand Gulf risks. It should have actively pursued available generation alternatives. In particular, NOPSI, instead of taking a 29.8% fixed share of Grand Gulf, NOPSI [*sic*] should have sought the least amount possible. But even assuming that NOPSI was required to take a share as a matter of "system" responsibility (or under a FERC ruling[64]), it should have sought to lessen and spread its risks through off-system sales of its share of Grand Gulf, just as it said it could do. (*Id.* at 10.) At the same time, NOPSI should have contracted for coal-fired sources of power to diversify and support its program of displacing oil and gas fired generation. (*Id.*)

Detailed Analysis

4. *NOPSI's Failure to Deal Realistically with the Rising Cost of Grand Gulf; the "Ostrich" Policy.*

The record in this case shows that the cost forecasts of Grand Gulf were skyrocketing even before Three Mile Island incident

[64]NOPSI's management has testified throughout these proceedings that it expected the FERC ultimately to make the managemental deci-

(Footnote continued on following page)

(CNO Exh. 36, MLH-19A at II-14 and 15). Thus, estimated construction costs had risen to $1.3 billion by December 1978, compared to the original estimated cost of only $.854 billion in 1974. Throughout this period, NOPSI never questioned the underlying assumptions of, or undertook any critical analysis of the estimated costs (CNO Exh. 28 at 40-41), despite its large stake in the outcome. NOPSI purported to rely upon cost estimates received through MSE, without examining their basis or validity, and it used them in seeking an automatic pass-through from the Council in 1980 (NOPSI Exh. 36, MLH-12 and 12A), at which time it projected great benefits from Grand Gulf. (CNO Exh. 29 at 108).

During the period of time in which Grand Gulf was constructed, cost forecasting by those involved in the nuclear industry was based on the so-called "engineering estimation" method. It was, in general terms, similar to the method by which a contractor estimates the cost of building a house (Tr. 1755). NOPSI's witness Mr. Whinney described the process as follows:

> Q. . . .What was the technique that was used by the industry?
>
> A. The technique, as I understand it, is that an engineer will estimate the amount of material by various quantities and the amount of labor required to design and construct a plant, and using specific unit costs, extend those costs to come up with costs to complete, usually adding some kind of management reserve or contingency to come up with a cost estimate, just the same way a builder estimates the cost of building a house for you. (Tr. 1755.)

There were several potential problems with the engineering estimation method. It was judgmental and susceptible to under-

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(Footnote continued from previous page)
sion as to how to allocate the costs of Grand Gulf—but this viewpoint, at best, matured only in later years and appears substantially to be hindsight. The idea of leaving major management decisions to a government agency is itself questionable.

estimation. It relied upon estimates as to how long various phases were going to take and how much elements were going to cost. Moreover, judgments had to be made as to the regulatory environment. Regulation affecting nuclear plant construction and safety matters had been recognized as the principal cause of escalating real costs of nuclear plants (Tr. 1760; CNO Exh. 38 at 58-59), but absent an empirical basis for estimating their effect, there was considerable opportunity for underestimation.

A far deeper problem affecting the engineering estimation method was that it was being invalidated by the facts, as conceded by one of NOPSI's own witnesses, Mr. McWhinney:

> Q. [O]utcomes are useful to evaluate the validity of a technique for estimation, aren't they?
>
> A. Yes, that's correct.
>
> Q. . . . Was the engineering estimation technique being validated by the outcomes?
>
> A. Mr. Wruble, the answer to your question is that the plants cost more than they were estimated ten years ago.
>
> Q. They cost more. They cost more, did they not, on an annual basis that exceeded the rate of inflation.
>
> A. I think that's correct.
>
> Q. All right.
>
> So that as I understand it, your testimony is that while the—the people in the industry were using engineering estimation to project a completed cost of a nuclear plant, the cost was always coming in substantially higher than the original estimate. Can you think of a case where it didn't?
>
> A. No, I can't.

(Tr. 1769-70)

Beginning in the mid-1970's, a number of statistical studies were made public that undercut the conclusions and validity of

the engineering estimation method. These studies showed that nuclear plant costs were increasing at a rate that was far in excess of both inflation and conventional cost estimates. The first was published in December 1974 by Professor I.C. Bupp of the Harvard Business School in conjunction with researchers at the Massachusetts Institute of Technology. (Tr. 1651-2; NOPSI Exh. 38 at 46.) There followed two studies by William Mooz, published by the Department of Energy and the Rand Corporation respectively, in 1978 and 1979. (Tr. 1652; NOPSI Exh. 14 at 46.) These studies were widely distributed and discussed in the academic community, in federal agencies, at the Electric Power Research Institute, and other institutions. (*Id.*) In addition, Mr. Komanoff, a witness here, published in 1976 a book applying statistical analysis to nuclear and coal plant on-line performance (Tr. 1654). Thereafter, he used the same analytical methods to assess nuclear plant capital costs and made his conclusions known in testimony before a state regulatory commission in October 1978 (Tr. 1507). He disseminated his findings in a speech in September 1978, and they were in turn reported in *Nucleonics Weekly* (Tr. 1507), a publication which was read or known by "most people in the industry." (Tr. 1842-43). Drafts of material which became Mr. Komanoff's 1981 book, *Power Plant Cost Escalation* ("*PPCE*"), were circulated in 1978. (Tr. 1508.) In addition, Mr. Komanoff testified before the Subcommittee on Energy and the Environment of the House Interior Committee in July 1979 as to the results of his statistical analysis of nuclear and coal plant costs and the implications of Three Mile Island. (Tr. 1663-4.)

The statistical method used by all three of the foregoing analysts is a widely accepted technique called "regression analysis." In contrast to the "engineering estimation" method, it utilized hard data from completed nuclear plants to measure the actual rates of increase in costs during the period and also to produce estimates of the effect on costs of various causal factors. (Tr. 1468).

NOPSI's witness Mr. McWhinney characterized the significance of the results being reached by use of this technique as follows:

Q. Let me do it this way. William E. Mooz, in his Rand Corporation study in 1978, determined that nuclear costs were increasing at a rate far in excess of that which had been presupposed in engineering estimates made during the 1970's, did he not?

A. Yes, he did.

Q. And Mr. Komanoff at the same time period has done exactly the same thing, hadn't he?

A. Yes . . . . .

(Tr. 1782.)

Mr. Komanoff described the significance of his work as follows:

Q. So, as I understand it, your determination as to cost increases in 1973 was not a projection of the future, but was based on hard data as to what in fact had occurred during the period of your studies?

A. That is correct.

Q. Now can you tell me roughly what the annual cost increase implied by the aggregate cost increase which you mentioned was?

A. Yes, sir. Converting this 150 percent increase over the total seven year completion period can be done in two different ways. If that total cost increase is broken down by date of completion, then the rate of increase averages about 13 percent a year. If instead it's broken down by the date of construction start, the increase is 24 percent a year.

Q. Let me understand the significance of this. As I understand your testimony, you found that there were real cost increases in nuclear plants, not inflationary cost increases, in the range of 13 percent annually, or 24 percent annually, respectively, based upon the categories you mentioned, isn't that correct?

A. Yes, sir.

Q. Now, this evidence that you brought forward based on statistical examination, was that consistent with or adverse to the figures that the nuclear industry had been giving out with respect to how much nuclear plants were going to cost?

A. These figures contradicted the prevailing beliefs and statements at the time concerning the rates of past increases in nuclear costs, the likely future costs of nuclear plants, and the relative competitiveness of nuclear and coal.

Q. And the implication thereof was that nuclear plants were going to cost more.

A. Yes.

(Tr. 1470-1475.)

The reason offered by NOPSI for its—and apparently MSE's—failure to make any use of regression analysis to develop the probable completion costs of Grand Gulf is its contention that the method "does not properly reflect what NOPSI knew or should have known in 1979" because it was "a new method . . . that was not at the time in wide use in the industry" (NOPSI Exh. 53 at 5). The method, NOPSI's witnesses contended, "was not widely known . . . and is, therefore, not an appropriate technique to use in a retrospective analysis." (*Id.* at 29.)

While NOPSI witnesses (Tr. 1773) and its counsel (*see* Tr. 1641-1648) stated or implied that the statistical method used was novel or radical, in fact the evidence showed that it was a standard method, widely used in the industry for other purposes (Tr. 1649). Mr. Komanoff testified,

> . . . The method . . . is the most conservative, traditional and commonplace method used for analyzing empirical data. It is used by all of these parties that you and I have both discussed here. It's used throughout the Federal Government. It's used throughout the electric utility industry to do load forecasting. It's used by the technical and policy communities par excellence. What these people had not done, was to apply this standard tool to measuring the current level of costs and the rates of past and current increases in the costs of nuclear plants. And I believe that it would have been logical, professional and appropriate for them to have done so at that time.

(Tr. 1646-7.)

NOPSI's witness Mr. McWhinney conceded both the method's use elsewhere in the industry (Tr. 1775) and that the method was the *standard* technique for determining trends.

Q. The method itself is not radically different. It's an acceptable method.

A. That's correct. It is not different. It is an accepted statistical method.

Q. As a matter of fact, would it be fair to say that *the method is the standard technique for distilling trends from empirical data.*

A. *That's correct.*

(Tr. 1774; emphasis added.)

The remarkable failure of Middle South, NOPSI and "the industry" to use regression analysis and to take account of the conclusions of the works of Bupp, Mooz and Komanoff can be explained on the basis that it was not in their interest to do so, as reflected in the following examination of Mr. McWhinney:

Q. The technique was new, regression analysis was new, that's your testimony?

A. No. The answer is regression analysis was not new.

Q. The use of regression analysis to evaluate trends in nuclear plant costs was, as far as you knew, new as of about 1978.

A. That's correct.

Q. And the information being generated by the application of that technique was less favorable to nuclear plant cost predictions than that being generated by the honored technique of engineering estimation, isn't that right?

A. That's correct. Cost estimates were higher than traditional estimates.

Q. Right. And in this—and the technique, the use of regression analysis to evaluate cost trends in nuclear plants was not accepted by—or not in widespread use or accepted by the nuclear industry in the period 1978 to 1980, according to your testimony, isn't that right?

A. What is correct is that it was not in widespread use. I do not know if it was accepted or used, but I believe that it was known by people within the industry who were making decisions.

Q. Now your testimony states on Page 30, and I quote—This is referring to 1979. "In the 70's—It was widely believed that in the 1970's, that, as both the industry and the NRC reached maturity, operating performance would improve." That's number one. Two, "regulatory turmoil would cease," that's number two. And three, "costs would level off, or even fall in real terms." Do you see that?

A. Yes.

Q. Now if you had read Mr. Mooz's report at that time and the conclusions that I read to you and that we reviewed, how would you have felt about those beliefs after having read that report?

A. They're in stark contrast.

Q. They're in stark contrast. And is their implication significant or insignificant with respect to the costs of nuclear plants?

A. They were significant, and I'm sure they received adequate attention in the minds of the decisionmakers in the industry who were concerned about what was causing these prices costs [*sic*] to increase.

Q. Is industry acceptance, in your view, Mr. McWhinney, a measure of—a useful measure of management prudence or imprudence?

A. The answer is no. Because, as I've testified, my evaluation of the prudence of a decision is based on either the information management had or could have had, and this information was available, and could have been used, if it were not.

Q. Could have been used, regardless of whether or not it was in widespread use?

A. That's correct.

Q. Because you're a management strategist in part, aren't you? Haven't you helped management strategize in terms of its business decisions?

A. Yes, I have.

Q. And so you would be interested . . . in the technical biases of the sponsor of particular informational views, would you not, if you were considering those in advising management?

A. Yes sir, I would.

Q. And these views were not acceptable, not favorable to the nuclear industry, were they?

A. Whose views are we talking about?

Q. Excuse me, the views that were resulting from Mr. Komanoff's analysis and Mr. Mooz's analysis were very unfavorable to the nuclear industry, weren't they?

A. I wouldn't categorize them as unfavorable. They were different. They had higher cost estimates than the output analysis.

Q. They had higher cost estimates, and cost was a very important factor, was it not, in determining what kind of plant was to be built with respect to the generation of electrical energy?

A. Yes. I've said the least cost option is the criteria that ought to be used in evaluating a decision in the industry.

(Tr. 1836-40.)

Thus NOPSI's position that Mr. Komanoff's conclusions should be rejected because they "differed radically" from the "prevailing view" in the industry in 1979 (NOPSI Br. at 43, 48-49) would require our giving credit now, to a position that deserved no credit then. There was clear evidence that the "prevail-

ing view" was manifestly inconsistent with empirical results and data then available to NOPSI and to the "industry."

That NOPSI (and as far as is known, MSE) failed to inform themselves of and use a standard analytical technique to evaluate the probable cost of Grand Gulf stands in such stark contrast to practices in other areas that it suggests more than inadvertent avoidance. For example, NOPSI's witness, Mr. Trumps, testified as follows:

> Q. Well, as part of your job, do you, with respect to forecasting, do you investigate the or appraise the validity of the techniques used for forecasting?
>
> A. Yes.
>
> Q. Do you concern yourself with proposed new techniques for forecasting to see whether or not you can integrate them in your operation?
>
> A. Yes.
>
> Q. Do you make people responsible for making sure that they are aware of current techniques for load forecasting?
>
> A. Yes. . . .

(Tr. 1030-1032.)

In contrast, despite the fact the regression analysis was the standard technique for distilling trends from statistical data, and despite the public dissemination of information regarding its application to nuclear plant costs, NOPSI and the "system" claim to have been wholly ignorant of it.

5. *NOPSI's Failure to Deal With the Impact of the Three Mile Island Incident*

It is important to understand that, even before the incident at Three Mile Island, there were major trends related to nuclear plant safety issues that would continue to increase Grand Gulf costs. Four principal sources of impending and future safety-

related changes, and thus higher costs, were apparent in early 1979:

> (1) Recent nuclear regulatory requirements had been issued that had not been imposed upon completed plants. These would be imposed on plants under construction. Even plants completed in the late 1970's did not reflect regulatory requirements then in effect, because the NRC often exempted plants under construction. This was particularly true of NRC requirements concerning manufacturing, testing and performance criteria for structural materials and basic components. The codes and standards for these were in a state of almost continual revision during the 1970's.
>
> (2) New regulations could be expected because of adverse operating experiences at existing nuclear plants. Development of remedial regulatory requirements lagged considerably behind problems and accidents occurring at operating plants. For example, new rules arising from the 1975 fire at the Browns Ferry reactor were still being drafted in 1979. NRC regulations in early 1979 probably reflected operating experience accumulated through 1976 and 1977.[65]
>
> (3) It was likely that there would be future adverse experiences, based on (a) the increasing population of plants and (b) the increasing rate of detection of safety risks. This was evidenced by a far larger number of safety-related bulletins issued by the NRC during the 1976-79 period than in the early 1970's.
>
> (4) A growing list of "unresolved safety issues" portended high costs. These were matters disclosed during individual licensing reviews for nuclear plants, which were held for resolution on a general basis. In early 1979, there were 34 items of potentially major safety significance outstanding. Lists of these issues were available to the public. Many of the issues related to plants such as Grand Gulf. (CNO Exh. 38 at 50-57.)

[65]To illustrate the magnitude of the revisions involved, it appears that the NRC had issued 143 Power Reactor Regulatory guides through 1978. Twenty-six of these were being reviewed as of March 1979, and another 25 new guides were under development. Virtually all portended higher costs for new plants like Grand Gulf.

As previously indicated, the industry recognized changing construction and safety regulations as the principal factor in nuclear plant cost increases. (*Id.* at 59.) The factors listed above would have indicated, in 1979, that the costs of Grand Gulf would have been approximately 40% higher than a comparable nuclear plant completed at the end of 1978. (*Id.* at 60.)

On March 28, 1979 an accident occurred at Unit II of the Three Mile Island nuclear power plant south of Harrisburg, Pennsylvania. Within two weeks, the President appointed a "President's Commission on the Accident at Three Mile Island," (Tr. 1272) to investigate what was characterized as "the worst accident in the history of commercial nuclear power generation."[66] The accident focused national press attention on safety issues. As the Commission noted,

> After many years of operation of nuclear power plants . . . the belief that nuclear power plants are sufficiently safe grew into a conviction. One must recognize this to understand why many key steps that could have prevented the accident at Three Mile Island were not taken. The Commission is convinced that this attitude must be changed to one that says nuclear power is by its very nature potentially dangerous, and, therefore, one must continually question whether the safeguards already in place are sufficient to prevent major accidents. A comprehensive system is required in which equipment and human beings are treated with equal importance.

As a result, major changes were recommended in the operations and organization of the NRC. Its Chairman, Mr. Hendrie, who testified in this case, was demoted. (Tr. 1287.) The incident had a profound impact on the licensing, construction time and regulatory scheme—and thus on the costs of nuclear plants. As Mr. Hendrie testified, the Three Mile Island incident, "came to dominate the thoughts in nuclear regulation for balance of that year and during the time since. . . . " (Tr. 1277).

[66]Report of The President's Commission on The Accident at Three Mile Island, Oct. 1979, p. 1. (hereinafter "TMI Report").

In the months following, there was substantial, well-publicized appreciation that TMI would have a profound impact on nuclear plant construction and costs. The reasons were summarized by Mr. Komanoff as follows:

> (1) The Three Mile Island incident undermined the credibility of both nuclear plant developers and regulators. It involved a degree of core damage that had previously been rejected by industry experts as impossible and which was thus placed outside the "design basis" used to set the required strength of reactor containments and the systems designed to mitigate accidents.
>
> (2) The accident underscored the ineffectiveness of NRC regulation and industry self-regulation when it was revealed that precursor accidents elsewhere[67] had not led to remedial steps. In addition, it exposed the practice of "grandfathering" plants, by which new safety regulations were not applied to existing plants.
>
> (3) Because the damage at Three Mile Island and much of the actual sequence of events during the accident extended beyond the "design envelope" assumed in safety analyses, the NRC was forced to extend the spectrum of design base accidents used for safety assessments. Particular attention was focused on core-damage accidents, and the plant systems designed to ensure that plants could deal with major core damage.
>
> (4) The NRC was forced to abandon its "single-failure" approach to accidents and to consider what would happen if two systems or components failed independently of each other.[68] (CNO Exh. 38 at 62-64.)

The TMI Report, released October 1979, continued "serious criticism" of the NRC (Tr. 1294). Mr. Hendrie affirmed that

[67]The Commission notes, for example, that a related accident had previously occurred at the Davis-Besse plant and was investigated by both the NRC and the reactor manufacturer. Despite warnings by the manufacturer's engineer, no information calling attention to the need for corrective actions in similar circumstances was provided to utilities prior to the Three Mile Island accident. (TMI Report at 10, 29.)

[68]See TMI Report, p. 52.

Three Mile Island precipitated a "wide-ranging review" of the whole structure of nuclear regulation, that such review was foreseeable in 1979, and that it had the potential to affect the costs and construction of Grand Gulf. (Tr. 1342-43.) This perception of the potential impact of Three Mile Island was evident as early as May 1979 and certainly no later than the release of the TMI Report in October 1979. (CNO Exh. 38 at 66-67). In July 1979, for example, Mr. Komanoff testified before the House Interior Committee that estimates of the increased capital costs of nuclear plants attributable to TMI were "absolutely open-ended." (Tr. 1663.)

The attitude of NOPSI's management toward the Three Mile Island incident is one that approaches determined denial. NOPSI's management witnesses seemed programmed to ignore TMI entirely. In testifying about the "very dynamic time" (CNO Exh. 60 at 29) and "dynamic changes" occurring in 1979 (*Id.* at 76). Mr. Hurstell, despite *several* opportunities to do so, failed to mention either the greatly increased costs of Grand Gulf or the Three Mile Island incident. (*Id.* at 77-81). After some prodding, Mr. Hurstell finally testified that "I guess that's correct that [TMI] was a factor at that time". (*Id.* at 81.)

The factors that Mr. Hurstell did mention in his pre-hearing deposition were the price of oil and gas, the Iranian situation (bearing on the availability of oil), NOPSI's lack of a firm fuel supply for 1100 MW of generation, the Fuel Use Act curtailing use of gas and oil as boiler fuel for generation, and the United Gas curtailments of natural gas to NOPSI, but *not* Grand Gulf costs and *not* Three Mile Island. (*Id.* 77-78). The factors mentioned by Mr. Hurstell, as has been noted, were neutral as between the choice of coal or nuclear fired power (Tr. 677)—which should have been a principal matter under consideration by NOPSI at that time, had it acted prudently. Months later, in his testimony at the hearing, Mr. Hurstell added, as a "concern" in 1979, the Clean Air Act—apparently to buttress NOPSI's position here that there were also concerns over increased costs of coal fired generation based on antipollution regulations. (Tr. 663.) But again he failed to mention the Three Mile Island incident. (Tr. 665.)

When Mr. Hurstell was asked whether he thought it might have been "a little risky" for NOPSI to "load up" on a share of an incomplete nuclear plant (a fixed share of 335 MW from Grand Gulf I and 335 MW from Grand Gulf II, Tr. 677) just after the Three Mile Island incident, the following colloquy ensued:

Q. Now, again, do you think that having NOPSI load up on incomplete nuclear plants after Three Mile Island was a little risky?

A. No. Our studies at that time indicated that our customers would benefit to the tune of about 2.3 billion dollars over a 12-year period of time and it was to their financial benefit for us to do that.

Q. And we're going to come to that in a moment, but just for now, that 2.3 billion dollar estimate was not done until 1981, isn't that correct?

A. That's correct. But 1981 was 1.8 over a shorter period of time.

Q. That's fine, but the number you just mentioned was not until 1981?

A. All right. I'll mention the one in 1980, 1.8 billion in a nine-year period of time.

Q. And that number—and I said we'll come to that in more detail later, but for the record now, that number was calculated based upon your projections of the completed cost of Grand Gulf at that time?

A. Not my projection, it was Middle South Energy's projection.

Q. So you just took their projection and worked it out?

A. I had to do that.

(Tr. 682-683.)

Thus, Mr. Hurstell's attempted justification of alleged savings (embodied in MLH-12A and 12B) was simply a spreadsheet extrapolation of numbers supplied by MSE (Tr. 683). Mr. Hurstell had no idea what assumptions had been used in the MSE figures for Grand Gulf, nor whether an adjustment for the impact of Three Mile Island was reflected in the figures. (Tr. 709; CNO Exh. 29 at 164.)

Mr. Hurstell testified not only that there were no meetings at NOPSI with regard to the impact of Three Mile Island on Grand Gulf costs because of alleged reliance on MSE, but also that he was not concerned about the Three Mile Island incident because no one "knew" what the impact would be:

> Q. All right. Now, were there any meetings at NOPSI with regard to Three Mile Island and the effect it might have on NOPSI's Grand Gulf costs in, say, the period of ten or eleven months following Three Mile Island?
>
> A. No, and for a very good reason.
>
> Q. I don't know if there can be any good reason but what is the reason you would offer?
>
> A. The reason is that we relied upon the expertise that was assigned to overlook the Grand Gulf project and that was MP&L.
>
> Q. Weren't you concerned yourself? You were a major buyer; you're now thinking about a commitment of 670 megawatts and there's Three Mile Island; you don't hold a meeting?
>
> A. Because Three Mile Island we don't know the impact at all. I know it was a significant impact that happened, but what was going to be the impact on the nuclear energy industry nobody knew in 1980, I'll say.
>
> Q. No one knew for sure, and didn't that bother you more than anything, there was a significant event that had not been quantified in a way you knew about, yet you took a risk on an incomplete nuclear plant?
>
> A. I can tell you my major concern at that time.
>
> Q. No. Were you concerned about that?
>
> A. I'll say no, I was not concerned. . . .

(Tr. 684-686.)

The result of NOPSI's inattention to unfolding events was that it was left ignorant of what prudent management should have known, and others did know, about the potential impact of Three Mile Island. Mr. Hurstell testified,

> Q. I think that at the time you had no—your testimony is that in the year 1979 you had no appreciation that Three Mile Island might result in substantially increased costs with respect to Grand Gulf?
>
> A. I had no idea, no, sir.

(Tr. 668.)

In rebuttal, NOPSI charged that Mr. Komanoff's (and others') views on the underlying nuclear plant cost trends, and the related impact of Three Mile Island, were outweighed by other authorities. Thus, Mr. Hurstell stated in prepared testimony as follows:

> "Speaking from NOPSI's perspective in 1980 Mr. Komanoff's views were overwhelmed by the abundance and quality of analyses provided by other credible sources from industry and the federal government."

(NOPSI Exh. 37 at 32.)

As a basis for this assertion, Mr. Hurstell referred to several analyses attached as exhibits to his prepared testimony. (*Id.* at 31-32.) At the hearing, he testified that all the analyses were examined in anticipation of NOPSI's making its January 1980 commitment for a large fixed share of Grand Gulf. (Tr. 757.) On cross examination, Mr. Hurstell's testimony as to reliance upon, and use

of, the cited materials turned out to be wholly unfounded. Specifically: The Gibbs and Hill Report (NOPSI Exh. 27, MLH-27) was first published on January 28, 1980 and could not have been relied upon by NOPSI (Tr. 758). Moreover, language, said by Mr. Hurstell in his prepared testimony to be from the report and to show a continuing advantage of nuclear over coal (*viz*, "nuclear continues to show a significant advantage over coal," *Id*. at 31), was not in the report at all, but in a transmittal letter (Tr. 759), and referred to inflation, *not* the impact of Three Mile Island. (Tr. 760-1, 763.) The report itself had raised an open-ended concern about the cost impact of Three Mile Island (Tr. 764-5), just as Mr. Komanoff had (Tr. 1541), as Mr. Hurstell so conceded under cross-examination:

> Q. . . . [W]ouldn't you agree that the report is indicating that there was a problem with Three Mile Island which will, in fact, have cost consequences and they are at the present undeterminable?
>
> A. Yes.
>
> Q. Open-ended?
>
> A. I believe at this time there are other entities such as the N.R.C. which are estimating a, $25,000,000 plant estimate at that time.
>
> Q. We will take these reports one by one, but, you see, if you talk about another report while I am asking you about this report, that's sort of an escape hatch, and I can't get you to talk about this report. So I need you to focus on this one. If you looked at it at the time as a prudent manager, that is the conclusion you would have come to, isn't it?
>
> A. That's correct.

(Tr. 769.)

Another report, the *National Energy Outlook* (NOPSI Exh. 37, MLH-26) was first offered as one that NOPSI relied upon in 1979 (Tr. 771), but it was a *1976* report, and Mr. Hurstell testified on

cross examination that NOPSI did not rely upon it in making its Grand Gulf commitment in January 1980. (Tr. 772.) Another, the *Environmental Report* (NOPSI Exh. 37, MLH-23), was prepared in March '79 by MP&L and did not in fact purport to reflect any of the costs of the Three Mile Island incident. (Tr. 775.) Moreover, Mr. Hurstell was unaware of the sources of information used by MP&L in producing the report. (Tr. 776.)

When the testimony turned to other reports—such as copies of two speeches by L.F.C. Reichele, one entitled "*The Economics of Nuclear vs Coal*," October 30, 1979 (MLH Exh. 28) and another of the same date by the entitled [*sic*] "The Urgent Need for More Base Load Electric Generating Capacity" (MLH Exh. 29A)—it turned out that Mr. Hurstell could not say that anyone at NOPSI reviewed the reports. More troubling is that the reports were not even found in NOPSI's files. Rather, they had been taken from LP&L files by an employee there at Mr. Hurstell's request in order to draft prepared testimony in this proceeding. (Tr. 781-786.)

The truth appears to be that in 1980, NOPSI's management never even considered Komanoff's work or that of Bupp and Mooz (Tr. 721), and it likely never read any of the reports which it filed as part of NOPSI's prepared testimony. Furthermore, Mr. Hurstell's attempt to testify as to NOPSI's reliance upon unspecified other reports was properly made subject to a motion to strike (Tr. 885) and is of "little value," as the Hearing Examiner correctly concluded. (Tr. 887.)

Turning to the issue of the potential quantitative impact of Three Mile Island, we find reasonable and well-founded Mr. Komanoff's contention that NOPSI should have estimated that the regulatory impact of Three Mile Island would add about 25 percent to the capital costs of Grand Gulf. Such estimate was based on a particularized analysis of the impact of Three Mile Island by Komanoff, previously discussed. (CNO Exh. 38 at

61-68.) It was offered as a "reasonable, probably conservative figure." (*Id.* at 68.)

To be precise as to the substance of Mr. Komanoff's position, he testified that NOPSI's management should have used a range of figures in order to show both the high and low ends of possible exposure. (Tr. 1628-29). He believed that, from the perspective of 1979, about 15 percent was the low end, and the high was "absolutely open ended."

In rebuttal, NOPSI's witness, Dr. Perl, asserted that Mr. Komanoff's 25 percent figure was excessive (when added to the 40 percent increase estimated to account for regulatory changes already unfolding and previously described.) However, since the real capital costs of nuclear plants had more than *doubled* in just the half dozen years since the early 1970's a 25 percent estimate appears reasonable.[69] There was a clear prospect that Three Mile Island would give rise to extraordinary demand for new actions to increase nuclear plant safety. (CNO Exh. 38 at 69.)

NOPSI also offered the testimony of Mr. Hendrie, former NRC Chairman. His testimony that the NRC staff had, in 1979, estimated the TMI regulatory impact at $20-50 million per unit, cannot be given great weight because of the witness' own concessions as to the low quality and origin of the estimate, which was not based on any study, and was "quick and dirty." He further testified that the NRC cost estimates were "uniformly" viewed by industry as underestimations. He also noted that the NRC did not have statutory authority to consider cost factors. (Tr. 1296-1299.)

[69]Indeed, Mr. Komanoff's estimate as of 1979, based on the 25 percent figure, was that Grand Gulf would cost $1475/KW, and turned out to be low. The actual cost at completion was substantially greater—$2253/KW (both figures in 1984 dollars without AFUDC). (CNO Exh. 38 at 69.) Actual results in 1984 are not a proper basis for evaluating a utility's prudence in 1979, and we do not rely upon them for that purpose.

Finally, NOPSI's assertion that the 25 percent Three Mile Island factor proposed by Mr. Komanoff should be discounted because Mr. Komanoff used a 17 percent factor in his book *PPCE* is not well-founded. The book characterizes the 17 percent figure as "conservative" (CNO 39, p. 283), whereas choice of a conservative figure by NOPSI in assessing Grand Gulf costs was not appropriate in the circumstances. In particular, Mr. Komanoff testified that prudent management should have considered a *range* of estimates. It is clear that if NOPSI had done so, it would have appreciated the seriousness of its possible exposure, and protective action would have been indicated. Moreover, use of the 17 percent figure would not greatly reduce the cost/benefit ratio of Grand Gulf to coal, *i.e.*, it would be reduced from 1.235 to 1.195.

In summary, NOPSI's assumption of a large fixed share of Grand Gulf reflects, at best, a corporate atmosphere of indifference; and at worst, an effort to postpone public awareness of NOPSI's serious predicament. NOPSI's witness, Mr. Louiselle, testified in a related proceeding that the allocation took place "after everyone realized what the cost of the unit was going to be." (CNO Exh. 33 at 856). AP&L was allowed by the "system" to withdraw from Grand Gulf participation on the basis of decreasing load growth and "political and regulatory pressures." (Tr. 528.) A group of municipal electrical electric companies, organized as the Municipal Electric Association of Mississippi ("MEAM"), dropped out of the Grand Gulf project sometime in 1980, but NOPSI's management, in particular, seemed to have little knowledge of why it did so. (CNO Exh. 29 at 127-138.) NOPSI, on the other hand, subscribed for a disproportionately large 670 MW share of Grand Gulf I and II, and had no plans for the purchase of coal-fired power, except for 80 MW almost a decade later. It remained unaware of important analyses of nuclear power costs, dismissed the importance of the Three Mile Island incident and failed to explore other options.

6. *NOPSI Should Have Realized, in 1979, that the Cost of Grand Gulf Power Would Be Uneconomic.*

Mr. Komanoff testified that, if NOPSI had employed a standard method of statistical analysis and had taken the impact of Three Mile Island into consideration, it would have determined in mid-1979 that the lifetime cost of Grand Gulf was likely to be about 20 percent higher than that of contemporaneously available coal-fired power. NOPSI's acceptance of a 29.8 percent share of Grand Gulf I (or 335 MW) "consigned the utility to an excess lifetime cost of approximately $320 million compared to available cost capacity, as costs could and should have been seen in 1979 during its negotiations leading to the 1980 Reallocation Agreement." (CNO Exh. 38 at 9.) Details of the calculation are set forth in Exhibits CK-2 *et seq.* of the Komanoff testimony. (*Id.*)

As it turned out, of course, the disparity between the costs of Grand Gulf and coal-fired power was much larger even than projected by Komanoff and has resulted in lifetime costs, by today's estimates, over *triple* those of coal-fired power. (*Id.* at 11.)

NOPSI's attempt here to undercut Mr. Komanoff's conclusions was not well-founded. NOPSI's expert witness suggested that the Council should make two major changes in the assumptions used by Mr. Komanoff (Tr. 1716).

a. *Capital Additions.*

The first change would involve deleting Mr. Komanoff's estimate of the cost of capital additions to both coal and nuclear plants. (NOPSI Exh. 53 at 41.) A deletion of capital additions would result in subtracting $500.8 million from the life cycle cost estimate of Grand Gulf I, but only $94.7 million for the coal alternative. NOPSI argued that costs for capital additions were not recognized as significant factors until after 1979. It pointed to the fact that the term "Capital additions" was not mentioned

in Mr. Komanoff's book *PPCE* or in certain testimony that he gave in 1981. (*Id.* at 39). However, capital additions were in fact treated in *PPCE* under the name "interim capital replacements." (Tr. 1550-52.) While NOPSI pointed out that in *PPCE*, regression analysis had not been used to project the costs of interim capital replacements, Mr. Komanoff answered satisfactorily that the *PPCE's* focus was almost entirely on *capital* costs,[70] and other costs were treated only in a summary fashion. (Tr. 1625-26.) In circumstances where NOPSI needed to evaluate, in a prudent manner, its Grand Gulf exposure, there would have been no reason for it not to have used standard statistical analysis for all its relevant costs. NOPSI certainly had the financial resources to engage such a study. (Compare Tr. 1625.)

b. *Operation and Maintenance Costs.*

The second change suggested by NOPSI was that operation and maintenance ("O&M") costs should be equalized for coal and nuclear, because, it says, such was done by Mr. Komanoff in *PPCE.* However, the analysis there involved a coal plant with a "scrubber," not comparable to ISES, which was the basis for alternate coal costs here. (Tr. 1635.) Equally important, Mr. Komanoff noted that in *PPCE* the O&M costs were treated in the same manner as capital additions—*i.e.,* only summarily. (Tr. 1635-39.) (Moreover, the ratio of O&M costs for a nuclear to a coal plant without scrubbers was stated in *PPCE* at 2.2-1, not the 1-1 ratio claimed by NOPSI.) (Tr. 1638; CNO Exh. 39.)

NOPSI's witness Dr. Louis Perl argued that Mr. Komanoff incorrectly evaluated historic trends in computing nuclear O&M

[70]This was an important point. *PPCE* is subtitled "Nuclear and Coal Capital Costs, Regulation and Economics." At the outset it states its objective as follows: "The book investigates nuclear and coal *capital* (construction) costs. . . ."(CNO Ex. 39 at 1; emphasis added.) The first ten of twelve chapters deal wholly with capital costs. Chapter 11, to which NOPSI refers, is entitled "Non-Capital Cost Factors" and contains only summary treatment of a number of other factors.

costs by relating such costs to unit vintage and age, instead of to time. (NOPSI Exh. 46 at 3, 10.) He asserted that Mr. Komanoff's approach assumed that the historic effect of regulation had been to drive up the costs for only new nuclear units, while it has in fact increased costs over time for both old and new units. Even if we accepted the premise that units of all ages were affected, it does not follow that a correlation to vintage implies an impact exclusively on new units, but rather that they are affected more, which appears sensible. Moreover, Dr. Perl's calculations did not carry forward the trend to project future O&M costs, presumably on the assumption that (despite persistent growth in O&M costs in the 1970's and the impact of Three Mile Island) such trends would not continue, which seems unreasonable. It is therefore difficult to assign great weight to Dr. Perl's position. In addition, Dr. Perl's presentation on this point was, by his own concession, not fully developed. (Tr. 1372-1376).

c. *Pricing Coal-Fired Alternatives.*

Apart from proposing the two major charges noted above, NOPSI also accused Mr. Komanoff of using impermissible "hindsight" because, in attempting to determine the costs of a coal-fired alternative in 1979, Mr. Komanoff used 1983-84 costs for AP&L's ISES coal-fired plant. (Tr. 1509-1512.) To the contrary, Mr. Komanoff used data as it existed in 1979-80 and took the approach noted with respect to ISES only as a direct result of NOPSI's blanket refusal here to provide data relating to other companies in the Middle South system. Because of this, Mr. Komanoff was obliged to reconstruct this data as it would have existed in 1979, taking note that AP&L was then engaged in building two identical coal-fired units—ISES and White Bluff, and that in 1979 White Bluff was almost complete. (Tr. 1515.) However, he did so in ways that involved conservatisms not favorable to his position (Tr. 1513-15), and this resulted in computations *more* favorable to NOPSI than would have resulted from using cost estimates actually available in 1979. (Tr. 1679-80, 1515-6.)

In this connection, Dr. Perl testified that Mr. Komanoff's cost projections for a coal-fired alternative were understated because he used adjusted White Bluff fuel costs as a surrogate for those of ISES, while in fact, as stated in Mr. Trumps [*sic*] rebuttal testimony, the costs of ISES were about 15% higher than those of White Bluff. (NOPSI Exh. 46 at 11.) However, Dr. Perl apparently failed to note that Mr. Komanoff had used a *higher* fuel cost escalation factor than that set forth in Mr. Trumps' testimony—the result being that if Mr. Trumps' base fuel cost and escalation rate had been substituted for those of Mr. Komanoff, the net effect would have been to *reduce* the fuel cost of the coal-fired alternative, which would work to NOPSI's disadvantage here. (Tr. 1525-26.)

Similarly, in reconstructing the capital costs for ISES, Mr. Komanoff used the actual ISES costs from 1983-4, which in real dollars were six percent *more* than White Bluff. His calculations "thus took on that six percent burden, which I am not sure that I would have done in 1979, . . . to be conservative." (Tr. 1516.) In addition, while Dr. Perl argued that Mr. Komanoff should have used a statistical method for the projection of ISES costs (NOPSI Exh. 46 at 11), this would seem to ignore the fact that ISES and White Bluff were identical, and that the costs of White Bluff were substantially established in 1979—thus presenting a more reliable basis for calculation.

d. *NOPSI's Selective Use of Cost Assumptions.*

A large part of NOPSI's cross examination of Mr. Komanoff involved requiring him to do recalculations based upon assumptions or factors favorable to NOPSI, but prohibiting him from taking into account any countervailing considerations. Mr. Komanoff was, for example, directed

> (a) to accept NOPSI's (actually, AP&L's) projection of White Bluff fuel costs, but to use Mr. Komanoff's own assumed escalation rates for such costs, rather than those of NOPSI (Tr. 1529);

(b) to accept the maximum of ranges when favorable to NOPSI—such as a 25 percent increase in coal O&M costs (Tr. 1668); and the minimum when favorable to NOPSI—such as the nominal amounts contained in *PPCE* for "interim replacements." (NOPSI Brief pp. 54-66.); and

(c) to alter the values in Mr. Komanoff's regression equation so as to adjust certain figures when favorable to NOPSI, but not to do so if unfavorable to NOPSI. (Tr. 1698.)

This approach to the calculations was properly dismissed by Mr. Komanoff as follows:

Q. . . . Now, I want to ask you, Mr. Komanoff, I want you to assume that an estimator in 1979 had made the calculations of the cost of Grand Gulf and the counterpart coal costs that were the subject of these calculations, just as Mr. Schultz directed you to do today, would you have regarded that as a professional product?

A. No, I would not. Any analysis or any conclusions in which an analyst systematically employed assumptions at one end of a range would obviously not be a professional work product.

Q. And adding to that the fact that you were asked . . . to cap certain factors and not cap other factors, would you have regarded that in gross as an unprofessional product if you had been the recipient?

A. Yes, I would have.

(Tr. 1673-74.) In our view, management's knowing use of such an analysis to reach decisions on important matters would have been imprudent.

e. *Role of Grand Gulf II.*

NOPSI's witness, Dr. Perl, also argued that Mr. Komanoff's calculations incorrectly estimated the cost of Grand Gulf I because they assumed that it would be a single-unit project. He asserted that the cancellation of Grand Gulf II was not contemplated in 1979, and that MSU and NOPSI should not be held to have anticipated that it would not be possible to complete the

Grand Gulf II unit. (NOPSI Exh. 46 at 3, 9-10). "It was only much later," Dr. Perl stated, "that increases in capital costs and interest rates made it necessary to defer Unit 2." (*Id.* at 10.) However, in 1979 construction on Grand Gulf II was minimal. If we accept, as we do, that a prudent analysis conducted in 1979 would have shown that Grand Gulf I was likely to be uneconomic, the cost trends would have been even more corrosive with respect to Grand Gulf II.

It is difficult to see how the completion of Grand Gulf II could have been deemed likely to anyone but its most dogged proponents. At the very least, NOPSI should have assumed the potential cancellation of Grand Gulf II as part of the range of prospects comprising its costs in 1979. There is no evidence that it did so.

7. *NOPSI Should Have Sought to Reduce its Grand Gulf Risk.*

We must start with the overriding observation that NOPSI's managers were clearly not, in 1979-1980, committed to take actions that would protect NOPSI's interest. Rather, NOPSI's management was apparently caught up in implementing the overall strategy of spreading the burden of Grand Gulf to areas where regulatory and political resistance was lowest, while publicly trying to pass off NOPSI's Grand Gulf commitment as a great "benefit." NOPSI acceded to AP&L's escaping its commitment entirely, while NOPSI committed itself to 29.8 percent of Grand Gulf —an amount that one of its own expert witnesses, Mr. Louiselle, had previously characterized as imprudent. (CNO Exh. 33 at 853). Mr. Louiselle testified in a related proceeding that the "reallocation took place after everyone realized what the cost of the unit was going to be." (*Id.* at 856.) Yet, as previously indicated, in September 1980, NOPSI's officers were before the Council, seeking an automatic Grand Gulf cost pass-through by means of a capability adjustment clause, and testified that this would result

in great benefits for ratepayers in New Orleans. (CNO Exh. 29 at 62-63.)

NOPSI made no Grand Gulf allocation proposal of its own, and NOPSI's president made no effort to resist the excessive Grand Gulf allocation and was even unsure of NOPSI's rights within the system to refuse to take so large an allocation. (Tr. 464-65.)

It is important to note that the FERC subsequently reduced NOPSI's allocation to 17 percent. This action mitigates the *results* of NOPSI's management imprudence because it curtailed NOPSI exposure by 12.8 percent of Grand Gulf. The FERC's action, however, in no way undercuts the negative judgment to be reached here on the prudence of NOPSI's management. Rather, it reinforces it.

Acting prudently, NOPSI should have reduced the risk of its Grand Gulf obligation by selling off as much of its Grand Gulf power as possible, considering all the circumstances, and by contracting for coal-fired power to displace its oil and gas-fired generation. (CNO Exh. 38 at 10.) Whether or not NOPSI had or would get an "involuntary" allocation from the "system" or the FERC, it was *not* "involuntary" for NOPSI's management to fail to explore a possible resale of part or all of its Grand Gulf power in order to reduce its exposure to the potential adverse economic impact of that nuclear project. This is not a difficult concept. Any prudent businessman, anticipating that his commitment to an obligation may prove excessive or uneconomic—say, a commitment to office space or raw materials—would take steps to "hedge" against or lessen the risks of that commitment through, say, subletting, or contracts for the future disposition of parts of the materials.

NOPSI's president twice stated in his testimony before the Council in 1980 that NOPSI could sell its Grand Gulf power to other utilities, and that it would do so if the Council so desired.

However, NOPSI's witnesses here sought retroactively to raise barriers and hindrances to such a sale by NOPSI. Such testimony is of little weight in view of the history of off-system sales on the system, and Mr. Cain's contemporaneous representations to the Council. There had previously been off-system sales of participation in generating plants owned by Middle South operating companies. (CNO Exh. 29 at 32.) Moreover, off-system sales of ISES and White Bluff participation were made by AP&L (NOPSI Exh. 40 at 6-7). While Mr. Trumps sought to distinguish these on the basis that the buyers were established "wholesale customers" of AP&L, the very fact that AP&L had off-system wholesale customers illustrates instead the ability of a Middle South operating company to deal off-system. Mr. Trumps testified as follows:

> Q. . . . The entities that you referred to were entities to which AP&L sold at wholesale? Isn't that right?
>
> A. Yes. They are approved rate schedules.
>
> Q. Were they on system companies at the time that they were wholesale customers? Were they members of the Middle South System at the time they were wholesale customers of AP&L?
>
> A. No, they were not.
>
> • • •
>
> Q. So there had been transactions with entities no part of the Middle South System which involved those companies, whatever the legal form of the transaction, buying power that was generated by entities on the system, whether or not by a purchase or as a participation in a plant, isn't that right?
>
> A. That is correct. You can go on—not only Arkansas but Louisiana Power and Light and Mississippi Power and Light had wholesale customers.

(Tr. 1053-7.) NOPSI's attempt at the hearing to revive this distinction was not persuasive. (Tr. 1072-3.)

Mr. Trumps also testified that a change made in the 1982 System Agreement reflected the existing practice of off-system sales.

Q. You stated in the second full paragraph quote, "The new service schedule in the 1982 System Agreement also established the principle that if a company has excess generating capacity, the other companies have the right of first refusal." Do you see that?

A. Yes.

Q. Why was it appropriate that that rule be established?

A. Why was it appropriate it be established in the 1982 System Agreement?

* * *

A. Okay. This particular principle is in there which *would obviously allow an individual operating company to make an off system sale if the other companies within the Middle South System do not choose to acquire it for themselves.*

Q. That is the way I read it.

(Tr. 1048-9; emphasis added.)

Several NOPSI witnesses sought to raise other entanglements to an off system sale, arguing *e.g.*, that if NOPSI had sold a portion of its Grand Gulf entitlement off-system and had sought to replace it with coal-fired generation, it would have had to buy 130% of the displaced power in the form of coal-fired generation because of reserve requirements. (Tr. 1236-7.)

At one point in the hearings, until objection was made, counsel for NOPSI and one of its expert witnesses apparently coached Mr. Trumps on answers to questions so as to make it appear that NOPSI was "trapped" by the system—*i.e.*, that it could not avoid additional allocations of Grand Gulf to make up for any amount which it sold off-system (1078-1079). However, Mr. Trumps ultimately testified that there were procedures that would have allowed NOPSI to sell off-system without increasing its Grand Gulf allocation. (Tr. 1080-1085.)

It should be noted that a sale off-system by NOPSI of part of its Grand Gulf power entitlement would not have undercut any financial obligation—established by the system or by the FERC—that NOPSI might have had with respect to Grand Gulf I. NOPSI, for example, could have remained financially responsible for its portion of Grand Gulf. A part thereof would have been sold to and paid for by one or more customers secured by NOPSI. The payments received would have been used by NOPSI to discharge its obligation to pay wholesale costs for its portion of Grand Gulf.

As indicated, NOPSI's president specifically testified before the Council in September 1980 that NOPSI could sell its Grand Gulf power off-system:

> "NOPSI has the option of selling capacity and marketing it which we think will be a very attractive commodity to other electric utilities who will view this as very cheap, reliable power for the future." (Tr. 792; Transcript of Sept. 17, 1980 Hearing at 547.)

And at another point,

> "[W]e will have the option of selling the unit and our portion of it to some other buyer." (Transcript of Sept. 17, 1980 at 561.)

Mr. Hurstell also testified that NOPSI could have sold its Grand Gulf power in 1980:

Q. Now you have also testified that Grand Gulf power was marketable in 1980, is that right?

A. Yes.

(Tr. 793.)

Furthermore, in March 1982, MSS, acting as agent for each of the Middle South operating companies (except AP&L which had been relieved of its Grand Gulf share), offered "all, or any part of, the capacity and energy" from the Grand Gulf I Nuclear Unit for sale to 57 different utilities. (NOPSI Exh. 36, MLH-21.) There were no takers. By that time, however, the cost forecasts for

Grand Gulf had risen so as to make the power virtually unsalable. (Tr. 795; CNO Exh. 29 at 142-149.)

Despite NOPSI's representations to the Council in 1980, NOPSI's witnesses argued that, as a matter of theory, no one would have bought any of NOPSI's Grand Gulf share in 1980 because, they said, if it were "prudent" for NOPSI to sell, it would have been "imprudent" for a buyer to purchase. (NOPSI Exh. 34 at 9.) Mr. McWhinney referred to the proposal to sell as a "greater fool" theory. (NOPSI Exh. 53 at 43.)

This view misses the point of the testimony and the realities prevailing in 1980. NOPSI conducted no prudent, critical examination of its Grand Gulf obligations. Had it done so, it would have found plausible the prospect that Grand Gulf would result in a massive liability. At the time, however, this would have been a forecast and not a certainty, as it is now. Moreover, prudent planners would have assessed a *range* of possible results. (Tr. 1628.) Given uncertain times and the imperfect foresight that inheres in any forecast, NOPSI could well have found one or more buyers—including buyers cognizant of the risks in nuclear power cost estimates. While NOPSI, a relatively small utility, was overloaded with nuclear commitments to both Grand Gulf I and Grand Gulf II and had virtually no coal ownership, utilities elsewhere with no nuclear generation could have viewed a purchase of some portion of Grand Gulf as a means of diversification. NOPSI, having made *no* attempt to seek a buyer when it should have done so, at a time when the company was publicly touting the prospective "benefits" of Grand Gulf and its president twice assured the Council as to the availability of buyers, cannot now be heard to say that there would have been no buyers.

In light of NOPSI's representations to the Council, the Council did not conduct a further inquiry, in 1980, into NOPSI's involvement in Grand Gulf. Moreover, in 1981, the Council agreed to allow a referendum to transfer regulatory control over NOPSI to

the LPSC, a move that proved to be detrimental in the proceedings before the FERC. Although the Council does not base its decision here on NOPSI's 1980 representations, NOPSI, by any fair standard, should be deemed equitably estopped to deny that it could not have sold power off-system and that the New Orleans' ratepayers now must bear the full burden of its imprudence.

The Council declined to approve the capacity adjustment clause proposed by NOPSI.

Mr. Hurstell, contrary to his prior testimony that Grand Gulf power was marketable in 1980, asserted a belief that there would have been no customers in 1980 for NOPSI's Grand Gulf power. His testimony, however, referred only to a few utilities (NOPSI Exh. 37 at 36), not the large number later solicited by MSS. Moreover, it cannot be squared with either Mr. Cain's testimony that the power could be sold; Mr. Hurstell's own testimony that the power was marketable in 1980; or the efforts made in 1982 to market the power.

Finally, the fact that NOPSI's share of Grand Gulf I was not a fixed amount (until NOPSI committed to a large share in 1980) does not excuse NOPSI's inaction. In the circumstances prevailing in 1979, NOPSI could be *sure* that it would be required to take (or would have access to) a sizeable share of Grand Gulf I, and certainly could have styled contracts giving it a right to sell a significant portion to others. Moreover, contractual clauses dealing with unexpected events would have been possible, if indeed they were necessary. Uncertainty is inherent in business decisions and did not entitle NOPSI to do nothing in the circumstances described.

8. *NOPSI Failed to Explore and Take Advantage of Opportunities to Purchase Coal-Fired Capacity as an Alternative to Nuclear Power.*

Because NOPSI was determined to portray Grand Gulf as a cheap source of energy, it never sought alternative sources (prin-

cipally coal-fired) as part of its program to displace oil and gas. Moreover, as NOPSI confirmed in response to the Council's data request number PC-4, it never undertook any comparison of Grand Gulf costs to coal-fired alternatives. (CNO Exh. 38 at 40.)[71]

NOPSI assumed a passive role, and did not consider purchasing any share of White Bluff because it "was not made available to us" (Tr. 502)—although forty percent of the plant was sold to non-system companies. (NOPSI Exh. 40 at 6.) NOPSI's president claimed to have discussed an opportunity to buy participation in the ISES coal plant but did not pursue it because of NOPSI's plans for Wilton. (Tr. 503.) However, NOPSI had no concrete commitment for the Wilton coal plant at any time. Moreover, the Wilton project was, in any event, almost a decade off; NOPSI's anticipated share of the project's capacity was relatively small (80 MW); and the likelihood of NOPSI's participation in Wilton was itself rendered problematical by the looming costs of Grand Gulf.

It is highly probable that coal-fired power was available to NOPSI during relevant period. For example, MP&L apparently began consideration of purchasing participation in ISES by no later than January 1980. The matter was actively discussed and negotiated in that year, and it was completed in 1981. MP&L's purchase involved 400 MW. Total sales to others by AP&L from the 4 units comprising White Bluff and ISES amounted to 1984 MW. (CNO Exh. 38 at 36.) There is reason to assume that NOPSI would have been able to participate also, had it actively pursued the matter, instead of passively assuming that no coal-fired power was available.

In addition, coal-fired power was available from the Southern Company for at least a five year period—certainly long enough

[71]Mr. Hurstell testified that a coal-fired alternative was not included in the "study" set forth in NOPSI Ex. 36, MLH-12 and 12A, because there was no coal capacity available (Tr. 691, 699), which does not appear to have been true, as indicated in the text that follows.

to give NOPSI an opportunity to let the "dynamic time period" settle and to seek other alternatives. While Mr. Hurstell claimed that he ignored this opportunity because Southern Company's coal-fired power was not available for the life-of-the-plant, this was certainly not a prerequisite to its being valuable. (Tr. 699-704; 911-913.) In related testimony before the LPSC, Mr. Hurstell stated that short-term purchases represented useful opportunities:

> Question: Mr. Hurstell, you just finished telling me 20 minutes ago that one year purchase of White Bluff or two year purchase of White Bluff or three year-year [*sic*] purchase of White Bluff is just as good as a permanent purchase of a unit, didn't you?
>
> Answer: Yes, sir.

(*See* Tr. 702-703.)

In contrast to NOPSI, MP&L's planning department performed its own analysis of ways to displace oil and gas generation, which led to the purchase of 25 percent (400 MW) of AP&L's ISES coal plant (NOPSI Exh. 38 at 41)—even though MP&L was the Middle South system's agent for the construction of Grand Gulf.

The record here reveals a situation in which one act of imprudent management led to other acts of imprudence and missed opportunities. NOPSI's acceptance of an excessive share of Grand Gulf I, and its commitment to extolling its illusory benefits, disabled it from participation in other, more beneficial projects. Mr. Cain testified before the LPSC in 1983 in response to cross-examination by the City's attorneys, as follows:

> Q. What are the ownership percentages of that unit [ISES] sir?
>
> A. I know the Arkansas Electric Co-op owns a percentage, Arkansas Power & Light owns a percentage. Now how —I think Arkansas and Mississippi own the majority, 51% and the remainder is owned by the Arkansas Co-op.

Q. Will you accept, subject to check, that Mississippi owns approximately 25% of the Independence Unit?

A. Yes.

Q. That is one example of one of the smaller operating companies on the Middle South System buying a portion of coal fired generation at the same time that it will have other nuclear fired generation, is that correct?

A. That is correct. And that opportunity, likewise, would have been made available to LP&L and NOPSI, but it could not be afforded.

Q. It couldn't be afforded because NOPSI and LP&L were getting such a high allocation of Grand Gulf power, is that correct?

A. That may be one reason sir. It may be because we did not have the rates that gave us the financial viability at the time to make the commitment.

Q. Well, if they got the same allocation of Grand Gulf power that Arkansas is getting, they certainly would have been able to afford 25% for participation in the Independence coal-fired generating station, is that not true?

A. I don't know if that would be true sir.

Q. What would you suppose sir in your best judgment as the Chief Executive Officer of LP&L and NOPSI?

A. I would assume that it would be true, but I don't know it to be true.

(CNO Exh. 30(c) at 104.)

In summary, despite the concerns NOPSI expressed about not putting all its eggs in one basket (see *e.g.*, Tr. 851), in January 1980, many months after TMI, and in the face of rapidly escalating nuclear costs, NOPSI failed to explore alternatives, failed to diversify and—without critical examination—committed to 670 MW of two units of an unfinished nuclear plant. At that time it had an unfirm expectation of attaining only 80 MW of coal, which would come on line, if ever, about a decade later. (Tr. 679-80.)

By failing to sell its Grand Gulf power as it said it could do, and by failing to acquire a source of coal-fired capacity, NOPSI had not only exposed itself and its ratepayers to extraordinary costs, but it also had abandoned one of the claimed rationales for Grand Gulf, the need to diversify. Thus, Mr. Cain testified in 1983 before the LPSC, again in response to cross-examination by the City's attorneys, as follows:

Q. Now, with respect to NOPSI's mix for fuel and base load generation, all of NOPSI's eggs for the present decade up until at least 1992 will be in the nuclear base load basket, is that true.

A. Base load generation, yes sir.

Q. And that is in one basket, in fact, it's the Grand Gulf Nuclear Generating Station, is that correct?

A. That's correct.

Q. Now, sir one of the reasons why NOPSI was originally interested in getting involved in a fuel diversification program, was the possibility of fuel interruption for oil and gas, isn't that true?

A. That's correct.

Q. And you did not want to be stuck with one source of base load generation that would be susceptible to potential shut-down or interruptibility, is that correct?

A. That's correct.

Q. Now, sir if there is an interruption for any reason in the Grand Gulf Nuclear Station, what impact will that have on NOPSI's base load generation from now until 1992?

A. It would be necessary to purchase replacement power from some other entity.

* * *

Q. So all of NOPSI's eggs in terms of base load generation are not only in one generating station, but they are in the highest incremental cost generating station in the System, is that true sir?

A. One of the two highest yes sir.

(CNO Exh. 30(c) at 101, 103.)

We find that NOPSI's conduct, throughout, fell far short of prudent utility management.

VII. *EVIDENCE REGARDING ECONOMIC IMPACT OF POSSIBLE REMEDIES*

A. *Procedural Background*

At the initial prudence hearing, written testimony submitted by both NOPSI and the City dealing with the economic impact of possible imprudence remedies was admitted into the record without cross-examination, on the basis that a subsequent hearing might be held to deal with that matter in detail. On May 20, 1986, the Council advised the Hearing Examiner to convene such a hearing. We set dates for discovery and the submission of additional testimony, which were later rescheduled, because of other obligations of both the Council and the participants. Our letter to the Hearing Examiner dated August 29, 1986, set final dates for submission of direct testimony by all participants on September 30, 1986, followed by rebuttal testimony on October 10, depositions thereafter and the commencement of hearings on October 21, 1986. As it turned out, NOPSI submitted no direct testimony, but rather filed "rebuttal" testimony on October 10, 1986 in response to direct testimony submitted by others.

The first hearing on the economic impact of possible remedies took place from October 21 to 24, 1986. During the course of the hearing, it became clear that the economic impact might be materially dependent upon the operation of federal tax laws. Tax reform legislation was under consideration during the summer and fall of 1986, and the Tax Reform Act of 1986 was enacted while the October 1986 hearing was in progress. NOPSI submitted an evaluation of the impact of the new tax law at the close of the October hearings (NOPSI Exhs. 75 and 76), but it has since stated that this was preliminary and should not be relied upon. However, it was apparent that, because of the new tax legislation, reconsideration of the testimony was necessary.

By letter dated November 5, 1986, the Council established a schedule for testimony, discovery and hearings limited to the impact of the Tax Reform Act of 1986. At NOPSI's request the schedule was extended. By letter dated December 2, 1986, the Council set a new schedule which called for a hearing to be held on February 24, 1987. It was held and concluded on that date. Following the submission of transcript changes and telephonic conferences, the Hearing Examiner advised the Council by letter dated April 16, 1987 that the record had been completed, and he submitted to us a certified index.

At the outset, it should be noted that an assessment of the economic impact of a remedy on NOPSI is not usually obligatory. NOPSI would not have the right to demand that it be undertaken. As the intervenors here correctly point out, a regulator has no general obligation to set rates so as to keep a utility solvent notwithstanding its imprudence. However, the Council believes that it has the right, and an obligation to the community, to investigate the impact on the financial health of the utility and consider that interest along with the ratepayers' interest in prudent utility management, in the overall interest of the ratepaying community. Moreover, there are special circumstances here. Although we believe that a disallowance based on the imprudence of NOPSI's management in retail matters not within the FERC's jurisdiction is fully within our authority, we are reluctant to take action that might prevent, although indirectly, NOPSI's paying its Grand Gulf costs, given the present legal climate and the prior indications of the federal courts.

B. *Overview*

As indicated above, the economic impact of possible remedial actions was initially assessed by the City's consultants, with NOPSI assuming a "rebuttal" role—although this sequence was not intended by the Council. The approach taken by the City's consultants was based upon financial projections created by using

NOPSI's own internal computer models. The existence of NOPSI's models came to light in an earlier stage of the ratemaking proceeding when, on February 5, 1986, NOPSI's senior financial vice president, Mr. McLetchie, filed "Additional Testimony" dealing with NOPSI's projected financial condition. This testimony prompted data requests to NOPSI by the Council's consultants which sought the basis of the financial projections upon which Mr. McLetchie had relied. On April 7, 1986 NOPSI responded by providing computer printouts showing projected sources and uses of funds for a number of years.

On July 23, 1986, in connection with the remedy phase of the prudence proceeding, the Council's consultants filed a data request seeking "complete financial forecasts," based on NOPSI's computer model, given several scenarios and assumptions specified by the consultants. The scenarios or "cases" included one in which there was no disallowance for imprudence (known as the "9B case"),[72] one in which there was a $50 million disallowance (the "10A case"), one in which there was a $150 million disallowance (the "10B case") as well as others that involved various percentage deductions. The assumptions will be discussed in more detail later.

Technical conferences were held between representatives for NOPSI and the Council relating to the data requests, in order to refine them; to reduce the effort required to produce them; and to deal with problems in the computer runs.

The general approach employed by the Council's consultants was to analyze the results shown in the "cases" to determine whether they portrayed plausible financial situations. If so, then it might be concluded that the imprudence deduction specified in the particular case was one that NOPSI could "sustain."

As described by Mr. Palast, a consultant to the City, the purpose of his testimony was to set "limits" so that an imprudence

[72]The numbers refer to the paragraph number of the data request filed by the Council's consultants.

penalty would be no more than the utility could "sustain" financially—based on the underlying assumption that the utility would take reasonable measures to conserve its cash flow and work in good faith for the success of a financial plan. (CNO Exh. 49 at 5-6.) NOPSI was viewed as able to "sustain" an imprudence penalty if it could thereafter meet its obligations and maintain service —that is, if it could meet its operating and maintenance expenses and interest due on outstanding debt; fund necessary improvements; and, importantly, pay the monthly cost of Grand Gulf I power, as allocated by the FERC. (*Id.* at 6.)[73]

Mr. Palast concluded that NOPSI could sustain a deduction of $150 million under either tax regime. He further testified that under the old tax law, NOPSI could have sustained a deduction of $150 million, plus 10 percent per month of the Grand Gulf I costs. Because the new tax law had some adverse effects on NOPSI's after-tax financial results, Mr. Palast's testimony concluded that the 10 percent additional disallowance should be lowered to 4 percent. (CNO Exh. 65 at 27.)

Mr. Cecil, another consultant for the City, also testified that NOPSI could sustain a deduction of approximately $150 million for imprudence, whether the financial computations were made under the old tax law or under the 1986 revision. He concluded that the change in the tax law had only moderately affected the financial impact on NOPSI of the possible imprudence disallowances, notwithstanding the relatively drastic change in the tax rate structure. This, in turn, implied that possible future adjustments in tax rates would also be unlikely to have dramatic impact. (CNO Exh. 68 at 6-8).

[73]It is important to understand that the cases do not necessarily portray what would actually be done by NOPSI to finance its obligations and operations—because there are limitless permutations and many options that could be pursued instead. Rather, a case established only that general level of disallowance could be borne by a plausible set of actions, to which there may be many alternatives.

Although NOPSI's witnesses vigorously contested these conclusions, they did not offer any alternative "limits." At best, Mr. McLetchie testified that a $50 million deduction would not "theoretically bankrupt" NOPSI. (NOPSI Exh. 85 at 12). Mr. Cecil, in contrast, concluded that a $50 million deduction would leave NOPSI in "a very strong financial condition." (CNO Exh. 68 at 9.) NOPSI's witnesses principally challenged the assumptions used in the computer runs and the feasibility of NOPSI's securing necessary funds through debt and equity investment in the circumstances that would prevail following an imprudence deduction. The evidence was extremely complicated, and witnesses on both sides challenged the methods, calculations and premises of their counterparts.

C. *The Financial Projections: Directions and Assumptions*

As part of their data requests, the Council's consultants asked NOPSI to provide "a complete financial forecast," in the form of computer runs (including, *inter alia*, an income statement, balance sheet, sources and uses of funds statement), and reflecting the "most recent information available" and the "Company's best judgment with respect to future events." (Data Request of August 4, 1986.) In addition, NOPSI was initially directed to make the following assumptions:

1. The interest rate on future NOPSI financing would not exceed 11 percent.

2. Revenues for the non-Grand Gulf portion of electric operations and for gas operations would not be affected by any imprudence deduction—so that the total revenue figures would be unchanged, except for the deduction itself.

3. Corporate tax laws would remain the same.

4. Grand Gulf II would not be included in the calculations (its future being unknown).

NOPSI's computer runs for the "no deduction" cases ("9a" and "9b" cases) on August 15, 1986 showed the need for additional instructions. Therefore, NOPSI was directed to make the following additional assumptions (which we number as a continuation of the above):

5. The return on average common equity for each calendar year beginning with 1988 would be approximately 14 percent, and the base rate increases necessary to maintain this return would become effective on January 1 of each year.

6. NOPSI's capital structure would maintain the ratios reflected in NOPSI's current capital structure—*i.e.*, long-term debt of approximately 55 percent.

7. Annual common dividends would be no greater than 10 percent of average common equity.

8. There should be no other material changes, but "if NOPSI were to discover some unanticipated error or were to conclude that a further change should be made," it should raise the matter for discussion.

Further discussions between the Council's consultants and NOPSI's consultants and employees followed NOPSI's provision of trial computer runs. Additional instructions and assumptions were provided to NOPSI, by letter dated September 2, 1986, as follows:

9. In addition to the specification that the annual common dividend be no greater than 10 percent of average common equity (as stated in the paragraph numbered 7 above), the annual common dividend should not exceed 70 percent of the "net income available to common" as reflected on NOPSI's Corporate Income Statement.

10. It should be assumed that the capitalization ratios shown on the Financial Statistics of a 55 percent limit on long-term debt and a common equity minimum of 34 percent would be maintained by purchase of NOPSI common stock by its parent, MSU.

Given these specific assumptions, together with the program and assumptions inherent in NOPSI's computer model, NOPSI was requested to provide complete financial forecasts for the period 1986-1995, under a number of "case" scenarios. Each was,

furthermore, to be based on the settlement set forth in Resolution No. R-86-112. The cases that became the principal focus of testimony were:

- 9(b): which specified that there would be no adjustment for imprudence.

- 10(a): which specified that there would be, as an imprudence adjustment, a $50 million reduction in the accumulated, deferred Grand Gulf I expenses otherwise recoverable, occurring as of December 31, 1986.

- 10(b): similar to 10(a), but specifying a reduction of $150 million.

- 10(c): which, as revised by letter dated September 18, 1986, specified that, in addition to the $150 million adjustment assumed by 10(b), there be a reduction equal in amount to 10 percent of the non-fuel Grand Gulf I expenses billed to NOPSI.

Succeeding runs under these scenarios also bore a number to indicate their identity. For example, "10(b)(4)" would reflect the fourth (and final) run for 10(b). In describing the output of computer runs below, we shall refer, unless otherwise indicated, to those which reflect the Tax Reform Act of 1986.

It is useful to examine, in the first instance, the 9(b)2 run, since it indicates NOPSI's projected financial condition in the *absence* of any imprudence deduction (but including its obligations under the rate settlement agreement). Under this scenario, NOPSI would be expected to borrow an aggregate of $205 million represented by bonds and debentures during the 5 year period 1986 to 1990,[74] and to repay $108 million of debt during the 5 year period

[74]The runs were done on the basis of a comparison that began with the year 1986. In fact, however, no imprudence adjustment was made in 1986. The testimony indicated that the periods in question could be moved so as to commence in 1987, without significant impact on the calculation. (Tr. 3387.)

1991 through 1995. NOPSI would be expected to sell $85 million in common stock to MSU during 1986-1990, and repurchase $98 million of common stock during 1991-1995.[75]

It is important to note that NOPSI would need to borrow debt and seek an equity infusion during the early period even *without* an imprudence penalty. Such need arises from the deferral and phase-in plan contained in the March 1986 settlement. NOPSI would begin to repay this debt and equity financing during the "phase out" period, when its revenues would exceed its Grand Gulf I costs. NOPSI's return on average common equity during the period would be 14 percent, a result dictated by assumption numbered 5, above. The mortgage indenture coverage (the ratio of net income to the interest required to be paid under the mortgage indenture) would generally be in the range of 2.36 to 3.17 throughout the period, except for the first year, which is considerably higher.

In comparison, assuming that NOPSI were to incur a $150 million reduction in deferred Grand Gulf I costs as a result of imprudence (the "10(b)(4) case"), the computerized financial forecasts generally showed the following. NOPSI would have to issue $125 million in debt instruments during the 4 year period 1986-1989, and could begin to repay them in 1990—so that $88 million would be repaid during the 3 year period 1990-1992. NOPSI would issue $105 million of common stock to MSU during the period 1986 to 1989, and commencing in 1990, NOPSI would repurchase its common stock from MSU, so that $105 million would be repurchased by 1992. MSU's return on its investment would be lower than in the no deduction case. Its return on common equity would be lowered to approximately 8.8 percent during the period (except for the year of the deduction, which would show a substantial negative return). (CNO Exh. 65 at 16-17.) Similarly, the mortgage indenture coverage would be lowered to a range of about 2.2 to 2.6 (except for a negative

[75](CNO Exh. 68, EAC-8, Sources and Uses of Funds, p. 3.)

coverage in the year of the disallowance, and a small coverage in the following year). (CNO Exh. 65 at 17.) Again, these results reflect NOPSI's meeting its service obligations, paying its debts, and meeting its obligations to pay for Grand Gulf I.

The fundamental question is whether the results shown by the 10(b)(4) run are plausible and in harmony with real-world financial circumstances. To answer this inquiry, Mr. Cecil stated the key assessment factors as (1) the maintenance of a reasonable percentage of common equity in the capital structure—a factor realized here by the input of assumption 10 above, (2) maintenance of reasonable interest coverage ratios, (3) the existence of a plan which gives assurance to NOPSI and the investors that deferred amounts will be recovered, and (4) sufficient base rate levels for the recovery of non-Grand Gulf costs. (CNO Exh. 46 at 23.) He concluded that NOPSI could sustain its operations and meet its obligations given a $150 million deduction, under both the new and old tax laws. (CNO Exh. 68 at 6-8.)

Mr. Palast reached similar conclusions as to the 10(b)(4) case. He noted that, except for the year in which NOPSI's books reflect the one-time charge for imprudence, NOPSI would experience positive earnings averaging 8.8 percent in the decade forecasted. He further noted that NOPSI would meet all its interest payments, while otherwise maintaining its operations, "with a comfortable margin of income." Specifically, by the second year after a write-off, the mortgage indenture coverage ratios would exceed 2.0. He also noted that Middle South would not be called upon to invest appreciably more in NOPSI than if there were no write-off at all, and NOPSI would begin returning capital to MSU in 1990. (CNO Exh. 65 at 18-20.)

NOPSI's witnesses reached conclusions substantially different from those of Mr. Cecil and Mr. Palast and contended that NOPSI could not sustain a $150 million imprudence disallowance. In order to highlight these differences and lay the basis for our own conclusions on the issue of relief, we have listed the

principal bases of disagreement below. Each of these matters will be treated as separate topics in the discussion that follows. They are:

1. NOPSI's contention that the Settlement Agreement contained an assurance that there would be no disallowance of Grand Gulf I costs in the prudence inquiry; that investors understood the settlement in this manner; and that were this understanding breached, investors would not rely upon any Council "assurance" in the future and therefore would not provide any financing to NOPSI.

2. NOPSI's contention that it is unreasonable to assume that rate relief will be granted on and after January 1 in each year in an amount sufficient to provide a 14 percent return on average common equity—thus challenging assumption number 5.

3. NOPSI's contention that it us unreasonable to assume that debt market funds would be available to NOPSI at 11 percent—or, indeed, on any reasonable terms—thus challenging assumption number 1.

4. NOPSI's contention that it is unreasonable to assume that MSU would make the required equity investment in NOPSI—thus challenging assumption number 10.

5. NOPSI's contention that the effect of the Tax Reform Act of 1986 is so adverse to NOPSI as to make it unable to sustain an imprudence reduction even if it could have done so under the prior tax law.

6. NOPSI's contention that there are no additional cost savings or cash generation measures available in order to aid its financing in the event of an imprudence deduction.

In the course of examining these principal contentions, a number of related matters will also be treated.

1. ***NOPSI's contention that the Settlement Agreement precludes prudence relief; issues of investor reliance and retroactive ratemaking.***

The rate settlement agreement between NOPSI and the Council of March 20, 1986 (Res. No. R-86-112) provides, *inter alia*,

that NOPSI would permanently absorb $51.2 million of the Grand Gulf I non-fuel related costs then incurred—the aggregate of which were then approximately $105 million. It further provides that the remainder of the costs theretofore incurred, as well as future costs, would be deferred and recovered pursuant to a schedule of increases contained in the agreement. For accounting purposes, NOPSI's books reflect revenues (the "deferred revenues") in amounts equal to, and based upon the company's anticipated recovery of, Grand Gulf I costs (and related carrying charges) that are not recovered through rates on a current basis.

NOPSI contends that the settlement bars any imprudence disallowance by the Council that would deny recovery of costs incurred by NOPSI and entered on its books as deferred revenues. This argument appears to have three variations. The first and principal argument is that the Council's approval of the settlement *ipso facto* gave "assurance" to investors that all deferred costs would be recovered. In particular, it is urged that investors who purchased $25 million of NOPSI's first mortgage bonds in July 1986 relied on such "assurances." The second variation is based on a technical and literal reading of the settlement agreement and contends that the Council is barred by the "plain meaning" of the agreement from issuing an order that would disallow any deferred costs. The third variation is that any such disallowance by the Council would be improper "retroactive ratemaking." The evidence is contrary to NOPSI's position on all of these points.

Our Resolution R-86-112 embodies the rate settlement. The last introductory clause of the Resolution states,

> WHEREAS, the Council deems a settlement to be feasible *only* if such settlement does not affect all existing legal rights of the City, including but not limited to rights concerning municipalization, *the investigation of NOPSI's prudence regarding Grand Gulf* . . . " (Emphasis added.)

In accordance with this premise, paragraph 26 of the Resolution states,

> 26. THE COUNCIL IS NOT REQUIRED TO CEASE ITS INQUIRY INTO THE PRUDENCE OF NOPSI'S INVOLVEMENT IN GRAND GULF OR TO REFRAIN FROM ISSUING ORDERS WITH RESPECT THERETO, UNLESS SO ORDERED BY A COURT OF COMPETENT JURISDICTION.

Paragraph 26 is set in capitalized type and is specifically designated within the agreement as a term "agreed to and accepted by both NOPSI and the Council."

NOPSI's argument that the settlement bars an imprudence adjustment that would reduce deferred revenues rests upon the testimony of expert witnesses that is itself not consistent. Mr. Robert Hahne, a partner of Deloitte Haskins & Sells ("DH&S"), which was an independent outside auditor for NOPSI in 1985 and 1986, testified that the only proper basis for deferring and recording costs under generally accepted accounting principles is the "assurance" that such costs will be recovered; that the settlement agreement provided such "assurance" with respect to the $54 million booked and deferred by NOPSI in conjunction with the settlement; and that DH&S gave its approval to the settlement on the foregoing basis. (NOPSI Exh. 66 at 4.) Mr. McLetchie, in his deposition, took this idea further and argued that the settlement gave "assurances" that all costs subsequently deferred under the phase-in plan would be "fully recovered according to the agreed upon schedule." (NOPSI Exh. 72 at 88.) Mr. Robert W. Jones, an investment banker whose firm has assisted NOPSI and SERI, stated that will investors recognized that the settlement agreement allows for the prudence investigation, they do not expect the Council to "reverse the deferred revenue already booked by NOPSI." (NOPSI Exh, 67 at 5.) Thus, Mr. Hahne appeared to address only the $54 million booked at the time of the settlement, leaving other future deferred revenues not necessarily subject to the alleged "assurances," while Mr. McLetchie referred to subse-

quent deferred revenues as well. Mr. Jones' position was not clear.

The testimony of NOPSI's witnesses is refuted by the facts. Prior to the settlement, Mr. Hahne's accounting firm (DH&S) had, in connection with its 1985 audit of NOPSI, issued an auditor's letter with substantial "qualifications" as to NOPSI's ability to continue as a "going concern." At that time NOPSI had incurred a huge Grand Gulf I obligation but had not yet been granted rate relief; and this, in turn, raised questions as to the availability of outside financing. After the settlement, DH&S removed its qualifications—but *not* on the basis suggested by Mr. Hahne that the Council had given the supposed "assurances" or had, by reason of the settlement, barred further disallowances. In an internal DH&S memorandum (CNO Exh. 55), DH&S personnel indicated concern that the settlement agreement left open the prudence inquiry, which "does raise doubt on the recovery of Grand Gulf I costs which *were deferred* in March 1986 in accordance with the settlement and with the *continued deferral*." (Emphasis added.) DH&S did *not* then believe that the settlement gave any "assurance" of recovery. DH&S's partner in charge, Mr. Quivey, dealt with NOPSI's Mr. McLetchie on this matter. Mr. McLetchie did not tell Mr. Quivey that the settlement was an assurance that NOPSI would obtain the deferred revenues. (Tr. 2915.) Mr. Quivey insisted upon receiving the opinion of NOPSI's legal counsel to address the issue. That opinion, obtained in discovery here, did not even suggest that the settlement barred an imprudence disallowance. Rather it implicitly assumed the *opposite* and opined instead that (1) NOPSI would prevail on the substantive issue of whether it was imprudent; (2) certain areas were preempted by federal law; and (3) any imprudence "damages" would not exceed the $51 million already reflected as a deduction in the settlement agreement. (CNO Exh. 56.)

DH&S's internal memorandum squarely places the reason for withdrawal of the qualification in its auditor's letter on the opinion of NOPSI's legal counsel and on its understanding of legal requirements concerning wholesale cost pass-through. (CNO Exh. 56 at 2.) Thus, in connection with a matter of major importance to NOPSI, and at a time when the proposition that the settlement agreement provided the requisite "assurances" would have been of great importance if true, mention of it is conspicuous by its absence. There is no evidence that NOPSI or its counsel asserted that the agreement either literally or by implied "assurance" barred disallowance of deferred costs based on a finding of imprudence, or that DH&S believed this to be true. The evidence is precisely to the contrary.

Similarly, NOPSI's witness, Mr. Jones, testified on cross-examination that in the public offering with which he assisted, (SERI's sale of $750 million of first mortgage bonds in September 1986), NOPSI's rate settlement agreement was considered a "material" event for federal Securities Act disclosure purposes. He affirmed that it was the subject of the "due diligence" meetings held for the offering. The resulting prospectus language, he said, did in fact inform investors that the prudence inquiry might result in a disallowance and rate reduction. (NOPSI Exh. 68 at 11-12.) Moreover, Mr. Jones subsequently took a contradictory position that we find untenable, to the effect that investors believe that NOPSI was entitled to recover imprudently incurred costs. (Tr. 2744.)

NOPSI's assertion that the "plain meaning" of the settlement prohibits a rate disallowance is meritless. NOPSI apparently contends that because certain conditions or numbered paragraphs were specifically referred to or cross-referenced within certain other portions of the settlement agreement, the fundamental con-

dition dealing with the Council's right to conduct its prudence investigation and to issue remedial orders, which is not specifically cross-referenced, should be disregarded. Post Hearing Brief of New Orleans Public Service Inc., April 10, 1987 at 15 (hereinafter "NOPSI Remedy Brief"). It argues that because the phase-in plan schedule contained no cross-reference to paragraph 26 (referring to the prudence inquiry quoted above), such paragraph 26 cannot provide authority for the Council to authorize a different rate recovery schedule. (*Id*. at 14-5.)

NOPSI goes on to argue, referring to the testimony of Mr. Cunningham (NOPSI Exh. 70 at 38-39), that the only action that paragraph 26 entitled the Council to take, if it found imprudence, was to order a lower return on common equity.[76] Mr. Cunningham's testimony in this regard was, however, elicited on cross-examination, in which he offered his "understanding" of the settlement agreement that the Council was virtually without any authority to issue a remedial order if it found imprudence. Ultimately, Mr. Cunningham testified that he was not told by anyone that there could be no disallowance by the Council of deferred costs set up under the settlement agreement. (NOPSI Exh. 70 at 42, 47). He finally conceded, "I am not going to say that somebody told me what the Council could do if they found imprudence." (*Id*. at 47.)

Mr. Cunningham was also allowed, over objection, to testify that if the Council were to issue an order that had the effect of preventing NOPSI from recovering the costs that it had booked as deferred revenues under the settlement, such a disallowance would constitute "retroactive ratemaking" and would thus be

[76]NOPSI also suggests that the Council could, under this language of paragraph 26, determine offsetting costs in base rates or "promulgate filing or other regulatory requirements." (NOPSI Remedy Brief at 16.) The former (the determination of offsetting costs), of course, has nothing to do with imprudence. The latter is simply without any substantive content with respect to the instant matter and could affect only future activities.

prohibited. (Tr. 2771 *et seq*.) This matter was a question of state regulatory law and did not require Mr. Cunningham's testimony; nor was he competent to testify on the matter. Moreover, NOPSI's brief here cites no legal authority that would support Mr. Cunningham's contention and we independently have found none. It is obvious that the imposition of such a disallowance would not constitute retroactive ratemaking because it was based on a right expressly reserved within the settlement order itself and involves rates that were expressly made subject to a possible remedy for imprudence.

On cross-examination, Mr. Cunningham was also confronted with NOPSI's Form U-1, filed under the Public Utility Holding Company Act of 1935, dated September 23, 1986 (CNO Exh. 61), which was inconsistent with his testimony. The disclosure set forth on page 10 of NOPSI's financial statements stated, in part, with respect to the prudence inquiry that,

> If the Council determines that any such actions or decisions were imprudent . . . it may attempt to prohibit the company from recovering from its ratepayers those costs associated with Grand Gulf I . . . incurred as a result of imprudent actions or decisions in excess of the unrecovered $51.2 million resulting from the settlement between the Council and the Company. However, the Company believes that all of its actions and decisions with respect to Grand Gulf I were prudent and that the company would ultimately be successful in defending against any attempt to quantify a finding of imprudence in excess of $51.2 million.

It goes on to state,

> The Company cannot predict the effect, if any, of the revised decision of the Court of Appeals in the course or outcome of the Council's prudence investigation and related litigation. (*Id*.)

Again, there was no suggestion in NOPSI's disclosure that the Council was barred by either the settlement order or rules against

"retroactive ratemaking" from disallowing, on the ground of imprudence, costs "in excess of the unrecovered $51.2 million." Moreover, the language further undercuts the claim that the settlement provided an "assurance" of recovery.

NOPSI's contentions place the Council in the unusual position of being told that it agreed to something other than that which we agreed to, and then being asked to adjudicate the matter. The rate settlement was made subject to the Council's continuing authority to conduct the prudence investigation and issue orders with respect to it. NOPSI and the investment bankers clearly understood that a common form of relief, if imprudence were found, would be an order disallowing imprudently incurred costs. (NOPSI Exh. 68 at 10-11.) The effect of the settlement is that NOPSI is entitled to rate relief under the schedule set forth therein, provided that no subsequent findings of imprudence were made and related penalty imposed. Such was the understanding when the agreement was entered into. Moreover, we believe that NOPSI had an advantage in some respects with respect to predicting the outcome under paragraph 26, because at the time the settlement was reached, it had greater knowledge of facts bearing on its prudence. NOPSI accepted the risk that the evidence in the prudence inquiry might result in a finding of imprudence and an appropriate remedy. There is no bar to the Council's ordering relief that disallows the recovery of costs imprudently incurred.

2. *NOPSI's contention that the financial forecasts are based on the unreasonable assumption that the Council would grant regular annual rate relief sufficient to maintain a 14% return on average common equity.*

As previously indicated, NOPSI was directed by letter dated August 21, 1986, to include an assumption[77] in the financial fore-

[77]The relevant text of the letter relating to the assumption is as follows:

> NOPSI should assume a 14 percent annual return on average common equity for each calendar year beginning with the year

(Footnote continued on following page)

casts regarding NOPSI's return on average common equity. This was based on the assumption that the Council would give periodic relief to cover increases in costs other than those associated with Grand Gulf I—which Mr. Cecil testified was no more than the assumption that the Council would act reasonably. (Tr. 1989.) Mr. McLetchie characterized this as a "highly questionable assumption," since, he said, it would require the Council to grant "prior to January 1 of each year, rates sufficient to cover the expenses of Public Service for the coming year and to allow Public Service to earn a 14% return on equity calculated as though there had been no prudence hit. It certainly has not been established that the Council would be willing to grant those increases." (NOPSI Exh. 71 at 4.)

The background of this assumption is important. On August 15, 1986, NOPSI provided financial projections to the Council's consultants that portrayed NOPSI as going bankrupt (or at least suffering continuous losses), even *absent* any imprudence deduction (*i.e.*, the original 9(b) case). This portrayal resulted from NOPSI's decision not to reflect any rate increases to cover increased costs arising from matters other than Grand Gulf. (CNO Exh. 49 at 40-41). That is, NOPSI *included* such increased non-Grand Gulf *costs* in the projections (about $250 million) but did *not* include any *revenues* from rate increases to offset such costs.

It appears that NOPSI's decision to omit non-Grand Gulf rate increases was intentional. Mr. Louiselle testified that in present-

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> 1988. This assumption will require the computer model to factor in annual base rate increases necessary to maintain the 14 percent annual return on average common equity. The forecasted base rate increases should be presumed to become effective on January 1 of each year, beginning with January 1, 1988. We understand that, to simplify the modeling procedure, the forecasted base rate increases will be shown entirely on the electric side. We also understand that the computer model may not produce precisely a 14 percent return on equity in each year, and that the return may vary a few tenths of a percent in one direction or the other.

ing the Council with forecasts that showed no rate relief responsive to increases in non-Grand Gulf expenses, NOPSI made a conscious decision to omit such rate relief, even if it portrayed NOPSI as going bankrupt. (NOPSI Exh. 79 at 92-96). He justified this on the basis that Mr. Palast had given testimony in the rate proceeding here (during the non-prudence phase) that any rate increase over 6 percent annually would have "catastrophic" results. (NOPSI Exh. 78 at 10). Mr. Palast did not so testify, but rather stated that annual rate increases over 6 percent would have a "measurable" impact on the community—*i.e.*, the adverse effects could begin to be measured—not that any increase over 6 percent would be a catastrophe.

NOPSI's position was inconsistent with that taken in NOPSI's own projections submitted in April 1986, (NOPSI Exh. 78 at 95-6), as well as with its normal forecasting practices—both of which assumed that there would be rate increases in the ordinary course to cover increased non-Grand Gulf costs, plus a return on investment. (NOPSI Exh. 72 at 45-47). The contrary assumption, implicit in the computer forecast presented by NOPSI on August 15, 1987, was not realistic or justifiable. (See cross-examination of Mr. Louiselle. Tr. 3027-29).

To rectify these implausible financial results, the Council's consultants instructed NOPSI to include a rate relief assumption which contained two necessary specifications: the level of return on investment that would be allowed by the Council and when it would be effective. NOPSI now asserts that this assumption is unreasonable because "It has not been established that the Council would grant such increases", (NOPSI Exh. 71 at 4) and that it is unrealistic to assume that the increases will occur as of the beginning of each year.

Mr. McLetchie conceded that the Council's methodology was essentially correct—that is, in the normal course of events NOPSI would periodically determine whether its rates were sufficient to recover costs plus a reasonable rate of return on equity, and

would seek rate relief if it appeared such costs would not be recovered. (NOPSI Exh. 72 at 55-57, 60). He contended that the assumption that rate relief would be granted by the Council each January was artificial, considering that in real world circumstances, relief would likely be sought at irregular time periods. But he conceded that NOPSI's requests for relief would in fact be timed and quantified so as to account for expectable regulatory delay. (*Id.* at 45-47 *et seq.*)

It is important to note that NOPSI did not offer any more "realistic" assumption to address this problem, even when pressed to do so by attorneys for the Council. (*Id.* at 62-63.)

For the purpose of developing financial projections to assess the level of imprudence adjustment that NOPSI could sustain, the assumption was a reasonable one. It is not necessary to believe that the Council will grant relief each January 1. Rather, the essence of the assumption is that NOPSI will be given timely rate relief that will cover legitimate increased expenses together with a reasonable return on rate base. Moreover, the utility of the assumption is a matter in which the Council plays a direct role. We have control of how much rate relief we will grant and how quickly we will do so. Basically, the Council can make the essential character of the assumption work, which NOPSI concedes. (Tr. 2933-34). The Council recognizes the need to deal fairly with future NOPSI requests for non-Grand Gulf I rate relief in a timely manner, and this consideration may be deemed embodied in our order issued herewith.

3. *NOPSI's contention that the forecasts are based on the unreasonable assumption that NOPSI could obtain debt financing at the rate of 11%; and its further contention that it could not obtain debt financing on any reasonable terms.*

As previously indicated, the computer-generated forecasts for the $150 million deduction case (*i.e.*, case 10(b)(4)) show NOPSI borrowing $125 million during the period 1986-1989, and beginning to repay its lenders in 1990. NOPSI objects to this portrayal

as unrealistic on a number of grounds, summarized as follows: (1) The forecast is unrealistic because it was based on its assumption that NOPSI's cost of borrowing would be 11%, which is unreasonably low; (2) NOPSI will, in fact, be unable to borrow on any reasonable terms, because of low income-to-interest coverage ratios and other financial circumstances that will arise following the imprudence "hit"; (3) the willingness of lenders to provide debt financing would be dependent upon the commitment of MSU to provide equity financing contemporaneously, and MSU will not provide such financing.

The dispute over the appropriate interest rate applicable to NOPSI's borrowing is less consequential than may first appear. NOPSI argues that if there were a large imprudence disallowance, the rating of its bonds would be reduced below "investment" grade to a "speculative" level,[78] and that this would narrow the number of potential investors considerably and would raise the interest rates NOPSI would have to pay. Although NOPSI issued $25 million in bonds in July 1986 at 11 percent, NOPSI notes that such bonds were ultimately to be secured by a property mortgage, while here there would be no property available to secure the debt financing required. Given these and other circumstances, its experts concluded that NOPSI would have to pay 12.5 percent to 15 percent in order to borrow the necessary funds. (NOPSI Exh. 71 at 6-7; NOPSI Exh. 67 at 9-10.)

The City's consultants noted that the 11 percent interest rate was specified by them only after NOPSI had provided runs that incorporated excessive 15.25 percent and 17.0 percent interest rates. They further noted that top-rated utilities were paying an average of about 9 percent on their borrowings, and that 11 percent represented a substantial premium; that SERI, which had

[78]Bond rating agencies have various classifications of the investment quality of a particular issue, utilizing a combination of letters. The fact that an issue is rated as "speculative" does not mean that it cannot be sold, but it would affect terms such as the interest rate and probably reduce the number of potential buyers.

"many of the risk characteristics of NOPSI," had sold a large issue of medium term bonds in September 1986 at 11 percent (NOPSI Exh. 49 at 45-47); that SERI subsequently sold $750 million of debt at between 9.96 percent for 5 year bonds to 11.65 percent for 30 year bonds; and that other "troubled utilities" had been able to raise debt at interest rates considerably below those proposed by NOPSI. (CNO Exh. 50 at 22; CNO Exh. 47 at 139-42).

It may be assumed *arguendo* that the interest rate NOPSI would have to pay lies somewhere in between these conflicting positions.[79] The more important point is that a change in interest rate of the magnitude involved here would not fundamentally affect NOPSI's ability to withstand an imprudence disallowance. A higher rate would become a legitimate cost of NOPSI "normally included in rates and paid by the ratepayers." (CNO Exh. 47 at 172-4.) NOPSI's witness Mr. McLetchie agreed that the Council has the power to grant rate increases that would allow NOPSI to recover its interest costs, whatever they may be. (Tr. 2936-38). Moreover, although a change in the level of interest rates might also play a role in calculating the income-to-interest coverage ratios, this would not be significant. (CNO Exh. 47 at 173.)

There was also considerable debate among the expert witnesses as to whether the coverage and capitalization ratios depicted in the financial projections were "healthy," "adequate" or "reasonable." (See NOPSI Exh. 67 at 7.) There was similar debate as to how NOPSI's situation would compare to those of other "troubled utilities," a number of which have obtained financing and maintained operations notwithstanding major disallowances for imprudence. (NOPSI Exh. 68 at 41-43.) It is probably not possible or necessary to reach conclusions, in the first instance, as to

[79]In May 1987 NOPSI issued $75 million of 10 year Rate Recovery General and Refunding Mortgage Bonds at 10.95 percent interest. In January 1988 NOPSI issued $40 million of similar bonds at rates ranging from 13.2% to 13.9% depending upon maturity.

whether such situations are sufficiently comparable in important respects to provide definitive guidance. It is important, however, to note that even NOPSI's witness did not contend that the necessary financing would be unavailable, but only that it would be "very difficult" for NOPSI to be "assured" of its ability to raise funds, if its debt securities were downgraded to "speculative" ratings. (NOPSI Exh. 67 at 9; NOPSI Exh. 79 at 74-79.) However, the level of the interest rate offered plays a key role in making such an investment attractive. (Tr. 2938-39.) Moreover, the assurance most critical to lenders is that they will in fact be repaid, and this appears to be a certainty under the projections. Both of these matters, it must be noted, can be addressed by actions of the Council.

Moreover, the projections in the 10(b)(4) case, which must be regarded as conservative[80], show that NOPSI's mortgage indenture coverage ratio exceeds 2.0x throughout the forecast period, except for the year of the write-off and the next succeeding year (CNO Exh. 65 at 17, GP-8)—a respectable margin for debt coverage.[81] Assuming other specifications in the 10(b)(4) scenario were met, particularly that of equity financing, there seems to be little question that NOPSI would be able to repay its borrowings in a relatively short time, so that long-term financing would not be required, even in the case of a $150 million write-off, and this

[80]As indicated in point 5 *infra*, NOPSI's 10(b)(4) case, reflecting projections under the new tax legislation, tends to understate NOPSI's net income.

[81]Assuming a write off of $150 million in a single year, the mortgage interest coverage in the year of the write-off is negative, reflecting the loss that would occur. The next year is 1.57 and all succeeding years exceed 2.0 (CNO Exh. 65 at GP-8). Under the terms of NOPSI's first mortgage bond indenture, NOPSI can issue additional first mortgage bonds only if pre-tax earnings are at least 2.0x the interest due on first mortgage bonds outstanding and to be issued—which, of course, specifies a margin of earnings over its interest requirements. It would not be expected that financing would be based on first mortgage bonds, so their coverage ratio would not act as an operative restriction. Other kinds of debt may be issued (See CNO Exh. 49 at 22-23; CNO Exh. 46 at 14).

should allow a more favorable interest rate. Mr. Palast noted, "By 1990, the Company may stop borrowing altogether and begin a long period of cash surplus during which time it will pay down debt and refund capital to MSU." (CNO Exh. 65 at 15.) Mr. Cecil emphasized that the key factor here was to assure the debt investors that they will in fact get their money back with interest through recovery of deferred costs. (Tr. 3356; CNO Exh. 46 at 13; Tr. 1991).

Because prospective lenders would be assured of being paid back on a timely basis, at an interest rate reflecting market risk, a determinative element here appears to be MSU's willingness to provide the equity that would be deemed necessary to complement the debt financing[82] and give confidence to the debt investors. This matter is treated in the next section.

4. *NOPSI's contention that it is unreasonable to assume that MSU will make the equity investment in NOPSI required to fulfill the financial projection.*

Under the $150 million deduction case, NOPSI would need to sell $105 million of its common stock to MSU over a 4 year period, as follows: 1st year—$25,000,000; 2nd year—$40,000,000; 3rd year—$20,000,000; 4th year $20,000,000. (CNO Exh. 68, Case 10(b)(4), Sources and Uses of Funds, p. 3.) Beginning in the fifth year, NOPSI could begin repurchasing the stock, and complete the repurchase within three years. (*Id.*)

NOPSI contends that MSU would be unwilling to make such an investment in the circumstances presented. The return on MSU's newly invested equity would be in the range of 9.5% annually,[83] which NOPSI considers too low and embodying a

[82]An equity-to-debt ratio of 30% is required by the Securities and Exchange Commission.

[83]In fact, Mr. McLetchie contended that MSU should properly look at the rate on its total historical invested equity, or about 2.6 percent

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"double penalty."[84] Moreover, NOPSI's witnesses raised the prospect that during the time when MSU would be required to make the investment, the preferred shareholders would have the right to take over NOPSI's board of directors, and that this in turn would make it highly improbable that MSU would be willing to invest any substantial sums.

This, it is said, would come about as follows: Because of the imprudence deduction, NOPSI would have a negative retained earnings balance through the end of 1991. (Tr. 2181, regarding Case 10(b); CNO Exh. 68, regarding Case 10(b)-4.) As a result of a limitation in NOPSI's charter and elsewhere, NOPSI could not pay preferred dividends in these circumstances.[85] Moreover, if NOPSI does not pay such dividends for four quarters, NOPSI's preferred shareholders, rather than MSU, can elect its board of directors. Thus, MSU would, NOPSI argues, be called upon to make significant investments in NOPSI under the "catastrophic condition" of the threat of a loss of control of the board, and MSU would not reasonably do so. (NOPSI Exh. 67 at 14; NOPSI Exh. 68 at 58-59.)

The prospect of the preferred shareholders' taking over the board is, however, not realistic. Even assuming that the preferred

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annually, not the 9.5 percent that it would earn on the aggregate equity remaining after the deduction together with newly invested equity. (NOPSI Exh. 72 at 114-117.) However, it seems to us that any investor, including MSU, would make its decision based on present and future returns, not on historical investments and not on losses incurred as a result of imprudence, which expectably is a non-recurring extraordinary event.

[84]Contrary to NOPSI's contention that the lowered rate of return constitutes a "double penalty", it is merely a mathematical result of the write-off itself. (CNO Exh. 51 at 151-2.)

[85]In their original analysis of NOPSI's computerized forecasts, the Council's consultants assumed that NOPSI could pay preferred dividends during this period. However, the misunderstanding arose because NOPSI's printouts erroneously showed such dividends being paid. (Tr. 2326.)

shareholders had the legal right to elect the board, they could not practicably do so for the very reason that they would need MSU's investment in NOPSI, and MSU would not make that investment if the preferred shareholders took actions to disturb MSU's control. (NOPSI Exh. 68 at 62.) The theoretical right of the preferred shareholders to take over the board would be neutralized by their need for MSU's investment. (*Id*. at 80-81.)

NOPSI's witness, Mr. Jones, who principally sponsored this argument, was pressed to explain what the preferred shareholders could do that would be adverse to MSU. Apart from stating conclusorily that they might take actions "beneficial" to themselves and "detrimental" to MSU's equity, Mr. Jones was unable to suggest any specific act that would help them but hurt others. (NOPSI Exh. 68 at 62-68.) At one point he suggested that the preferred shareholders might force the company into liquidation to reclaim their equity and accrued dividends. However, it is unlikely that, during the five year period of NOPSI's negative retained earnings, the preferred shareholders would be able to realize their investment in a liquidation. (*Id*. at 72-76.) Instead, they would have the compelling incentive to continue the company as a going concern and attempt to secure MSU's continuing investments.[86]

We believe it evident that it would be in MSU's interest to make, and that it would in fact make, the investment required to ensure NOPSI's success following an imprudence deduction. MSU would have to make substantially the same equity investment whether or not there were any imprudence deduction, and it will get its money back beginning in 1990. (Tr. 2127; Cecil Dep. CNO Exh. 47 at 92; CNO Exh. 65 at 20, 28, Exh. GP-13.) As-

[86]Apart from the facial implausibility of the threat that the preferred shareholders would take over the board, there was other expert testimony that the risk to MSU was insubstantial (Tr. 2130), and that in similar circumstances where a utility had passed preferred dividends, the preferred shareholders took no action. (CNO Exh. 51 at 130-2, 141.)

suming that MSU will be repaid as the projections indicate, the only disadvantage MSU might incur is earning 9.5 percent on its investment instead of 14 percent. However, MSU's management would have to consider, against this, the consequences if MSU did not make the investment. In that circumstance, MSU would be likely to lose the entirety of its historical investment in NOPSI, which even after a $150 million deduction, would be approximately $25 million, and MSU probably would lose the right to future control of NOPSI. (NOPSI Exh. 72 at 121-128.)

Ultimately, of course, the Council has the power to take steps necessary to assure that MSU will be in a position to begin recovery of its equity investment within a few years after making it and to recover substantially all of it. One of the Council's own expert witnesses, Mr. Cecil, testified that MSU should be given such assurance. (CNO Exh. 47 at 83.) Mr. McLetchie, in turn, testified that—(1) if the Council did undertake to provide NOPSI periodically with adequate rate compensation for its increased non-Grand Gulf expenses to assure debt investors that their principal will be repaid along with compensatory interest, and to give MSU the aforementioned 9.5 percent return on its investment; and (2) if the debt investors indicated that, having been given the aforesaid assurance of recovery, they would invest if MSU also did so—then he could not say that MSU would not invest, and that such circumstances constituted a "great improvement." (Tr. 2933-2964.) In short, the Council can largely control or influence the actions that would make the plan work.

Finally, while NOPSI seemed to suggest that MSU did not have, or could not get, the funds necessary to make the investment (CNO Exh. 47 at 117; Tr. 2025), it appears that, as of the time of the hearing, MSU had $150 million in available, temporarily invested funds (NOPSI Exh. 86 at 76-77) and probably could raise more. In any one year, MSU's investment would not exceed $40 million. (CNO Exh. 68, Case 10B4, Sources and Use of Funds, p. 3)

We conclude that the financial projections shown for the $150 million deduction case are, on the evidence, feasible and plausible.

5. *NOPSI's contention that the Tax Reform Act of 1986 is so adverse that NOPSI could not sustain a significant imprudence deduction even if it could have done so under the prior tax law.*

For the most part, analysis of this contention is subsumed in the prior discussion because we used as our starting points the 9(b)(2) and 10(b)(4) cases, both calculated consistently with the Tax Reform Act of 1986. Thus, the conclusions we have reached do in fact take into account the effects of the new tax law.

Moreover, NOPSI's computer forecasts for the 10(b)(4) case, upon which we have relied, appear to contain two errors that portray financial circumstances more difficult than should be the case. First, the imprudence deduction itself would have a tax effect. The aggregate revenue reduction resulting from the imprudence penalty would result in a lower tax payment and thus more net post-tax income. However, in calculating the results of the new tax laws in the 10(b)(4) case, NOPSI showed the detrimental aspects, but it failed to include the tax reduction effect of the write-off; in fact, it merely used the same taxes shown in the no-deduction 9(b)(2) case for the 10(b)(4) case. (CNO Exh. 68 at 4.)

This was a "substantial error." (*Id.*) The overall understatement of NOPSI's revenues in the 10(b)(4) case was $170 million. (Tr. 3152.) Although most of this additional revenue would be realized by NOPSI in later years, especially 1993 to 1995 (CNO Exh. 68 at 4), nevertheless it would certainly be of importance to debt and equity investors as additional funds available to repay them for the investment made during the earlier "phase-in" years, when NOPSI's revenues would be less than its expenses. (Tr. 3241 *et seq.*)

Another error in the 10(b)(4) run, less substantial in amount, affects the calculation in the earlier years of the effect of the

alternative minimum tax ("AMT"). Under the AMT, half of the difference obtained by subtracting income for tax purposes from book income is treated as a "preference" item on which a ten percent tax must be paid. (This results in an AMT credit carry-forward, usable against taxes in later years.) In the early years, 1987 to 1992,[87] NOPSI would experience a "negative difference" between its book and tax income; this could be used to reduce the consolidated taxes of the several Middle South system companies, which file a consolidated return. There is an Intercompany Tax Agreement ("ITA") among these companies that prescribes, *inter alia,* that a company contributing to a tax reduction generally realizes the benefit of the contribution. While the current version of the ITA does not specifically contemplate the operation of the amended AMT, Mr. McLetchie testified that it would be his position that NOPSI should realize the benefit of the AMT reduction it will have generated as a result of the imprudence disallowance. (NOPSI Exh. 68 at 59-68.) Such a result would make several million additional dollars available to NOPSI in the earlier years. (CNO Exh. 50 at 9-10.)

Finally, it appears that the changes in the tax law work complementally with NOPSI's cash demands. In the three year period 1987 to 1989, NOPSI would actually fare about $12 million better under the new tax law than previously, and this is a period in which NOPSI would have substantial cash needs because of the "phase-in." In the next three-year period, 1990 to 1992, NOPSI would fare $27 million worse under the new law, but it is a period in which NOPSI would, in the aggregate, receive a tax refund and, beginning in 1990, be in a position to begin retiring the investments made to finance the imprudence deduction. In the next three year period, 1993 to 1995, NOPSI would actually fare $98 million better under the new tax law. (Tr. 3160 to 3192.)

[87]These time periods were based on assumptions in the testimony of a prudence adjustment occurring in 1987. However, the same basic conclusions pertain if the time periods commence in a later year.

In summary, we believe that Mr. Cecil correctly concluded that the new tax law has not drastically changed the impact under the 10(b)(4) case of a $150 million deduction, and that this is suggestive that future tax changes are not likely to have dramatic impact either. (CNO Exh. 68 at 6-8.)

6. *NOPSI's contention that there are no additional measures available to aid NOPSI in its financing in the event of an imprudence deduction.*

The foregoing conclusions have been reached without taking into consideration any specific cash conservation measures available to NOPSI other than those inherent in the computer forecasts. However, certain additional measures were suggested by Mr. Palast, and there was extensive testimony as to the availability of funds arising from the reconstitution of NOPSI's pension plan. These matters are treated below.

Mr. Palast suggested that NOPSI could utilize capital leases and sale-leasebacks in order to boost its cash flow—at the level of 50 percent of NOPSI's new plant spending—but without resort to selling and leasing back major current assets, including NOPSI's headquarters. (CNO Exh. 49 at 54.) NOPSI has responded that this level is unrealistically high in that the balance of forecasted construction additions for 1987 through 1995 ranges from $21 million to $31 million per year, and about $17 million to $21 million per year is needed to back certain of its debt obligations, leaving about $6 million per year available for leasing to provide cash flow, and this is further constrained by tax laws. (NOPSI Exh. 71 at 22.) The evidence is not sufficiently developed for us to reach a conclusion in this matter, beyond stating that some undetermined amounts could be utilized for a leasing program to generate cash flow.[88]

[88]As previously indicated, NOPSI sold $75 million in new bonds in May 1987. The terms of the indenture underlying the bonds prohibit sale and leaseback arrangements. However, those terms may have to be

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It was also suggested that NOPSI could utilize short term borrowing and finance its accounts receivable. NOPSI was, it turned out, able to secure a line of credit from Hibernia Bank in the amount of $10 million following the rate settlement. NOPSI contends, however, that a substantial disallowance would trigger a "no material adverse change clause" in the credit agreement and possibly preclude further use of the line of credit. (NOPSI Exh. 71 at 23.) NOPSI apparently also has access to short term borrowing from the Middle South money pool, an arrangement in which companies in the System either lend excess funds or borrow on a short-term basis. NOPSI contends that all borrowings are "on demand" and are available only on a short term basis, not compatible with the financing needs posed by an imprudence deduction. (*Id.* at 24.) Moreover, regarding accounts receivable financing, NOPSI did in fact enter into an arrangement for accounts receivable financing in the amount of approximately $25 million, but its ability to utilize this source may, as a practical matter, be limited.[89]

Another possible measure available to the Company is the recapture of excess funds from NOPSI's pension plan. (CNO Exh. 49 at 54-55.) Extensive testimony was taken on this issue from the Council's consultant, Mr. Camus, and from Mr. Haneberg, the actuary for NOPSI's pension plan.

NOPSI's pension plan is a "defined benefit" plan, which is to say that the plan specifies the benefits to be paid to NOPSI's

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renegotiated for other reasons in view of the Council's action here, and we do not therefore take such restrictions to be necessarily inflexible. Similar terms were contained in NOPSI's issuance of $40 million of bonds in January 1988.

[89]Subsequent to the hearings, NOPSI issued $75 million in General and Refunding Rate Recovery Bonds, the terms of which restrict its use of short term borrowing and accounts receivable financing. Specifically, NOPSI was obligated to terminate the latter by August 21, 1987. It cannot incur short-term debt (one year or less maturity) above a formula limitation. For reasons previously indicated, the specific terms that NOPSI negotiated with its lenders in this instance may not be absolute restraints.

employees upon their retirement. (CNO Exh. 48 at 4; NOPSI Exh. 80 at 2.) NOPSI's plan generally defines annual benefits as a percentage of a beneficiary's highest five year average salary multiplied by the beneficiary's years of service in the Company. (CNC Exh. 48 at 5; NOPSI Exh. 80 at 2.) NOPSI makes annual contributions to the plan in amounts calculated, by actuarial methods, to provide these benefits. (CNO Exh. 48 at 4.) The plan's benefits do not increase automatically when the plan becomes overfunded. (*Id.*) Rather, NOPSI must formally amend the plan to effect an increase in benefits. (*Id.*)

Mr. Camus testified that NOPSI's pension plan is overfunded, and calculated the excess assets in the plan to be $31.2 million as of December 31, 1985. (*Id.*) He estimated that the excess amount could have grown to $41 million by mid-1986, due to gains in the stock market during the first half of that year. (*Id.* at 8-9) Mr. Camus testified that these excess funds could be recaptured for the Company's use following termination of the plan, with full protection for NOPSI's employees and retirees. (*Id.* at 3-4.)

According to Mr. Camus, such terminations are becoming a common means for companies to free up excess pension plan assets. (*Id.* at 3.) Termination of plans, and reversion of funds to the employer, are governed by the federal Employee Retirement Income Security Act, as recently amended by the Single Employer Pension Plan Amendments Act of 1986 ("SEPPAA"), which simplified and shortened termination procedures. (*Id.* at 9.) Upon termination, plan assets are distributed to beneficiaries in the form of insurance company annuities, and excess assets revert to the employer. (*Id.* at 13.) The employer may elect to establish a new plan for future accruals of benefits. (*Id.*)

Mr. Camus emphasized that NOPSI's employees and retirees could be protected from any losses to their expected benefits under these procedures, and depending on the size of the insurance carrier chosen, would likely be *safer* from loss than under the current NOPSI plan. (*Id.* at 13-15.) Benefits accrued at the time

of termination would be guaranteed by the insurance company, which typically has surplus funds much greater than the surplus of NOPSI's plan. (*Id.* at 15.) The Equitable, for instance, had surplus funds in excess of $1 billion at the time of Mr. Camus' testimony. (*Id.*) Further, future accruals of benefits could be provided through the establishment of a new plan, at NOPSI's discretion. (*Id.* at 14.) Mr. Camus cited a recent study commissioned by the federal Department of Labor, which studied 97 representative termination applications pending before the Pension Benefit Guarantee Board after January 1984. The report concluded that individuals' accrued benefits at the point of termination were "fully protected." (CNO Exh. 48 at 11.) Moreover, all but six of the 97 plans were replaced with new plans, most of which provided identical or greater benefits than their predecessors. (*Id.*)

The basic elements of Mr. Camus' testimony are undisputed and, for the most part, are supported by the testimony of Mr. Haneberg. Mr. Haneberg testified that the NOPSI plan is overfunded (Tr. 3057), and agreed that Mr. Camus' figure of $31.2 million was a reasonable estimate of the excess on a termination basis. (NOPSI Exh. 80 at 8; Tr. 3058.) In fact, Mr. Haneberg performed his own calculation of the excess as of October 1, 1985, and found it to be $30,900,000. (NOPSI Exh. 80 at 5.) He did not offer a more recent figure. Mr. Haneberg knew of no legal impediment to termination of NOPSI's plan (Tr. 3058) and agreed that the excess funds, with certain adjustments, would revert to the Company upon termination. (Tr. 3058.)

We conclude that termination and reestablishment of NOPSI's pension plan could provide the company with an influx of cash. Although the reversion may be subject to one or more significant offsets (including, for instance, a ten percent federal excise tax, *see* CNO Exh. 48 at 16-17; NOPSI Exh. 80 at 8-11), as well as to fluctuations in the stock and bond markets, the amount of the reversion is potentially several tens of millions of dollars.

The Council also takes no position as to whether NOPSI *should* terminate and reestablish its pension plan, but merely notes that this source of cash is available. Moreover, it may be proper that the money resulting from the reestablishment of the plan should promptly be returned to the ratepayers.

Mr. Palast suggested that upon termination, NOPSI should be granted free use of the reverted funds to finance a portion of its phase-in expenses, but that the funds be returned to consumers by amortizing the sum to rate income over twenty years. (CNO Exh. 49 at 54-55.) We do not rule on this matter as neither the termination of NOPSI's plan nor the ratemaking treatment of the reverted funds is presently before us.

We also note that the witnesses took issue over several matters, including the extent to which adjustments would partially offset the reverted funds, the timing of the reversion, and the cost of a new plan. None of these undermine our conclusion that termination and re-establishment of NOPSI's pension plan could free up millions of dollars.

In short, while the amounts remain unclear, and while we do not rely on the availability of financing from any of the measures noted above, NOPSI appears to have other significant sources of funds available to it to meet its financing needs following an imprudence deduction.

VIII. *IMPRUDENCE DISALLOWANCE*

On the basis of the record before us, we conclude that NOPSI's conduct fell short of prudent utility management, to the detriment of its ratepayers and its shareholders as well. NOPSI's conduct has resulted in higher than prudently-incurred costs to the company and an unnecessarily strained financial condition. We conclude that a disallowance in rates is warranted in order to spare the company's retail ratepayers from the full consequences of management imprudence and, in line with traditional ratemaking law, that NOPSI's shareholders should bear the consequences of management imprudence. However, the disallowance

remedy we will direct in the circumstances here recognizes the need to balance the interests of the company's ratepayers with those of its shareholders (and creditors) and the particular circumstances in which this matter has arisen.

If NOPSI were a company with greater financial resources, a larger disallowance than what we order here could be considered, without imperiling the company's ability to continue to pay its monthly bills to SERI for power purchases from Grand Gulf I and continue as a going concern. The reality is, however, that NOPSI has limited financial resources. As a result, NOPSI, on the evidence here, can sustain only a limited disallowance in rates for imprudence, and still continues as a viable concern making payments to SERI for Grand Gulf I power and meeting its responsibilities. We do not think it unreasonable to create a remedy appropriate to these circumstances.

Accordingly, the Council directs that $135 million of NOPSI's currently deferred Grand Gulf I expenses be disallowed from recovery in retail rates in the future. This disallowance is in addition to the $51.2 million absorbtion of deferred Grand Gulf I expenses that NOPSI agreed to in March, 1986. A one-time write-off of $135 million in 1988 is within the limits which NOPSI can sustain and still continue its payments to SERI, according to the evidence. In fact, the $135 million disallowance is somewhat less than the $150 million amount (and more) which certain experts concluded is sustainable. The reduced disallowance will, in our view, provide a buffer or margin of approximately ten percent to allow for the uncertainty inherent in financial projections and for the possibility that circumstances could change to NOPSI's detriment.

A one-time write-off of $135 million will, of course, have a substantial effect on NOPSI's financial condition for one or two years, following which time it is expected that NOPSI's financial condition will improve rapidly. Even during this time, however, NOPSI will be able to continue to pay its bills to SERI for Grand

Gulf I and remain a viable concern. This assumes willingness by NOPSI's shareholder, MSU, to infuse a reasonable amount of common equity in NOPSI (to be repaid to MSU in the early 1990's). We believe such an assumption is fair and warranted, because shareholders should share the cost burden[90] of managerial imprudence and in light of the Council's efforts to maintain NOPSI's solvency and ability to discharge its responsibilities by adopting a moderate imprudence remedy.

Mr. Cecil presented three alternatives to adjust NOPSI's rates to reflect a disallowance by the Council here. (CNO Exh. 68 at 9-11.) We believe that NOPSI's ratepayers should see some of the effect of the disallowance, through reduced rate increases, prior to the end of the phase-in plan in 1996-7 adopted in Resolution R-86-112. Our order, in effect, adjusts the increases in the Company's electric rates and charges specified in Resolution R-86-112. This is, in our view, within the Council's reservation of right to conduct this inquiry into the prudence of NOPSI's involvement in Grand Gulf and issue orders with respect thereto.

NOPSI's rate increases reflected in Paragraphs 4 and 5 of Resolution R-86-112 shall, in effect, be adjusted as follows, to reflect the $135 million disallowance ordered here. For bills rendered on and after April 9th of each of the following years, NOPSI shall be allowed to increase its base rates on an annual basis by the following additional amounts:

1988—$16.6 million;
1989—$17.3 million; and,
1990—$18.1 million.

For bills rendered on and after April 9th of years subsequent to 1990, NOPSI shall be entitled to increase its base electric rates by 4.5% of $420.7 million compounded annually until: (a) Grand

[90]NOPSI's ratepayers already share this burden to the extent that the $135 million disallowance ordered is less than half of what Mr. Komanoff recommends, at the low end of his range. Mr. Komanoff found that the imprudence of NOPSI's management kept NOPSI from realizing savings amounting to between 62 and 31 percent of its cost of Grand Gulf I. A $150 million disallowance would represent approximately 16 percent of the cost of Grand Gulf I to NOPSI. (Tr. 3331.)

Gulf I costs are being fully recovered on a current basis, and (b) the amounts previously deferred, less $135 million of disallowance, have been fully recovered.

NOPSI shall reflect the disallowance by reducing the amount of deferred Grand Gulf I expense to be collected in future years by $135 million. The reserve for deferred taxes applicable to the deferred Grand Gulf I expenses shall also be adjusted to reflect the appropriate tax effects of the disallowance. NOPSI shall not be permitted to recover from ratepayers any carrying charges on the $135 million reduction, from the date of the disallowance forward.

The remedy ordered by the Council shall be a one-time disallowance and adjustment. With this remedy, the prudence inquiry of NOPSI's management vis-a-vis Grand Gulf I is terminated, and no further amount of disallowance shall be considered in the future.

Moreover, in order to ensure that the economic effects of the disallowance are in harmony with the expert testimony here, the Council recognizes its responsibility to act in a timely fashion to meet NOPSI's legitimate needs in the future for rate relief based on increased costs and similar grounds.

Our order here today does not prejudice or affect in any way pending litigation pertaining to Grand Gulf, including the City's abrogation lawsuit against NOPSI, litigation before the United States courts in the 5th Circuit and the District of Columbia Circuit, and proceedings before the Federal Energy Regulatory Commission.

The evidence here regarding decision-making by NOPSI's management also leads us to conclude that there is need for some form of regulatory review of substantial, long-term commitments into which the company proposes to enter before such commitment is undertaken. Alternatively, substantial commitments could be conditioned upon specific approval by the Council.

There are presently statutory provisions requiring certification by the Council of a plan by NOPSI to begin construction of any

new physical plant, or to extend or add to any existing plant, if the cost exceeds two percent of the company's rate base at the time of such construction, extension or addition. LSA-R.S. 33-4406. The Council must certify that the public convenience and necessity require the proposed construction, extension or addition of physical facilities, and the Council is the sole and final judge of what the public convenience and necessity require, in every instance. (*Id.*) No such certification was ever requested by NOPSI for its Grand Gulf commitment because, the company argues, its commitment is a purchase of power that falls beyond the scope of LSA-R.S. 33-4406 (*i.e.*, its purchase of Grand Gulf power does not constitute construction, extension or addition of any physical plant, equipment, property or facility as covered by the certification requirement).

Although this issue is now being litigated in a lawsuit in Louisiana state courts, it is important for this Council to consider the adoption of a requirement, by resolution or ordinance, that requires NOPSI to seek certification by the Council of any purchase commitment in the future, which, when viewed in its entirety, represents a significant potential impact on NOPSI and its customers, in excess of, say, two percent of its then-current rate base.

It is the Council's intention to consider the promulgation of a certification or approval requirement for the company's purchase commitments in a separate docket to be initiated following the issuance of this order. All parties and the public will have the opportunity to make their positions on such a proposal known to the Council at that time.

The foregoing findings are determinations having been reviewed by the Council, the roll was called, and the result was as follows:

Yeas:

Nays:

The foregoing findings and determinations are adopted.

APPENDIX A

JOHN B. FARMAKIDES
ATTORNEY AT LAW
5835 UPTON STREET
MCLEAN, VIRGINIA 22101 (703) 241-0006

May 21, 1986

The Honorable Joseph I. Giarrusso
Council President
New Orleans City Council
1300 Perdido Street
New Orleans, LA 70112

Re: Matter of Ex-Parte Application of New Orleans Public Service, Inc. for Increase in Electric Rates. Doc. No. CD-85-1

Dear Mr. Giarrusso:

This is to advise the City Council that the record of the above captioned proceeding was closed by agreement of the parties and the Hearing Officer on May 7, 1986.

Pursuant to City Council direction, the hearings called for this proceeding were held, as duly noticed, on March 4, 5 and 7, and on April 8, 9, 10, 11 and 14, 1986. During these eight days of hearing, some 116 Exhibits were introduced into the record, and direct testimony or depositions, obtained from 33 witnesses, were incorporated as part of approximately 2,400 pages of transcript. Following completion of the hearings the parties were offered an opportunity to correct the transcripts and the hearing record index.

The record includes all the exhibits, testimony, letters and documents admitted, transcripts developed, and the procedural Resolutions, Ordinances and other regulations referenced. The original and one copy of the record is in the custody of Ms. Emma Williams, Clerk of the City Council. An index, which may also serve as a log of the record, has been prepared and is submitted herewith. Also submitted for your convenience, is a copy of the May 7 memorandum closing the record.

In my opinion, the hearings proceeded in an orderly manner, and an adequate record was developed in accordance with the requirements of the City Council. The record is hereby delivered to the City Council.

Yours truly,

/s/ JOHN FARMAKIDES
Hearing officer

cc: All Councilmen
Okla Jones, II, Esq.
Thomas Milliner, Esq.
Jon Eckert, Esq.
Brod Bagert, Esq.
Clint Vince, Esq.
Glen Ortman, Esq.
Beverly Zervigon, Esq.
Bruce Naccari, Esq.
Mr. Gary Groesch
Mr. Jose Cierra
Bernhardt Wruble, Esq.
Herschel Abbott, Jr., Esq.
Thomas Lind, Esq.
Emma Williams, City Clerk

Before the
City Council of New Orleans

Matter of Ex Parte Application of New Orleans Public Service, Inc. for an Increase of its Electric Rates. Docket No. CD-85-1

Memorandum for the Record: May 7, 1986

By telephone conference call on this date among Bernhardt Wruble, for the City Council, Herschel Abbott, Jr., for New Orleans Public Service, Inc. (NOPSI), Gary Groesch, for Citizens for Safe Energy, and with Jon Eckert and Kelly Meehan of the City Council research staff, the Hearing Officer convened a meeting of the parties. The matters discussed and actions taken were as follows:

1. The Hearing Officer noted the decision of the City Council in response to the issue he had raised concerning the proffer of the testimony of George E. White, Jr. on behalf of NOPSI. That decision was contained in two letters of the City Council, dated April 22, and April 30, 1986, wherein the City Council outlined a schedule of events and actions to be taken.

2. Also noted were the letters of NOPSI in response to the City Council, dated April 28, and May 2, 1986, contending that the schedule and conditions set for the receipt of the proferred testimony amounted to a denial of procedural due process and were not acceptable. (The name of Jon Eckert in the letter of May 2 was corrected to read Kelly Meehan.)

3. In view of the referenced documents in items #1 and #2, above, and the ensuing discussion, the Hearing Officer concluded that no further hearings were in order, and, accordingly, with the agreement of the parties, the record was closed.

4. It was also agreed that any transcript corrections to be offered by any party shall first be transmitted to the other two parties with copy to the Hearing Officer. In order to

complete this item, any such proposal shall be accomplished within 5 days. Any objections to such proposed corrections shall be made within 3 days of receipt, with copy to the Hearing Officer. That Officer will address the proposal, and any related objection, and make an appropriate determination for the record.

5. A copy of the record to be certified to the City Council will be transmitted by the Hearing Officer to the parties in draft form as soon as possible. Any proposed correction, amendment, etc., by any party, shall be transmitted to the Hearing Officer within 5 days, with simultaneous copy to the other two parties. The Hearing Officer will resolve any disagreement and certify the final record.

6. No other matter having been presented, the record was closed as noted and the telephone conference was concluded at 4:10 p.m., April 7, 1986.

/s/ JOHN B. FARMAKIDES

John B. Farmakides
Hearing Officer

Before the
City Council of New Orleans

Matter of Ex Parte Application of New Orleans Public Service, Inc. for an Increase of Its Electric Rates. Doc. No. CD-85-1

The official *RECORD* of the above captioned matter, compiled as of May 7, 1986, is set forth below in items 1 through 135 as follows:

A. Application, and Procedural Documents

1. Application for permanent rate relief, as filed by New Orleans Public Service Inc., on May 17, 1985, and resubmitted on Sep. 30, 1985 and Oct. 11, 1985.
2. Rules of Practice and Procedure, Ordinance No. 828 MCS (As amended) Art.VI, Sec.52-100 *et. seq.*,
3. Referenced Resolutions of the City Council: R-85-636, Oct 10, '85; R-85-741, Dec 2, '85; R-86-43, Feb 6, '86; R-86-52, Feb 6, '86;
4. Referenced Letters of the City Council: S.Barthelemy to J.Cain dated Jan. 29, 1986; S.Barthelemy to J.Cain dated Feb. 14, 1986; S.Barthelemy to J.Cain dated Mar. 26, 1986
5. Certification of motion to City Council by Hearing Officer, dated April 14, 1986, and his Memorandum for the Record, dated May 7, 1986.
6. Determination by City Council on motion submitted, with Notices for continued proceedings, dated April 22, and April 30, 1986.

B. Exhibits: New Orleans Public Service, Inc.

7. NOPSI—Cunningham Ex. 1A
   Original testimony of
   S G Cunningham
   filed on May 17, 1985 ..... Mar.4:Tr. 33
8. NOPSI—Cunningham Ex. 1B
   Additional testimony, Feb. 5, 1986 .. Tr. 33
9. NOPSI—Cunningham Ex. 1C
   Rebuttal testimony, Feb. 26, 1986 ... Tr. 33
10. NOPSI—McCletchie Ex. 2A
    Original testimony filed May 17,
    1985 ..... Tr. 83
11. NOPSI—McCletchie Ex. 2-B
    Additional testimony, Feb. 5, 1986 .. Tr. 83
12. NOPSI—McCletchie Ex. 2-C
    Rebuttal testimony, Feb. 26, 1986 ... Tr. 83
13. NOPSI—Randall Ex. 3
    Original testimony filed May 17,
    1985 ..... Tr. 119
14. NOPSI—Abadie Ex. 4-A
    Original testimony filed May 17,
    1986 ..... Tr. 122
15. NOPSI—Abadie Ex. 4-B
    Rebuttal testimony filed Feb. 26,
    1986 ..... Tr. 122
16. NOPSI—Quivey Ex. 5
    Rebuttal testimony filed Feb. 26,
    1986 ..... Tr. 135
17. NOPSI—Triech Ex. 6
    Original testimony filed May 17,
    1985 ..... Tr. 168
18. NOPSI—Cain Ex. 7-A
    Original testimony filed May 17,
    1985 ..... Tr. 172
19. NOPSI—Cain Ex. 7-B
    Additional testimony filed Feb. 5,
    1986 ..... Tr. 172

20. NOPSI—Cuthbert Ex. 8
Pg. 1 of 4 of Exhibit R.W.C.-5 ..... Mar. 5: Tr. 49

21. NOPSI—Cuthbert Ex. 9
FERC Opinion #234 rendered June 13, 1985 ..... Tr. 73

22. NOPSI—Cecil Ex. 10
Copy prepared direct testimony before L.P.S.C. Docket # U-15689 .. Tr. 168

23. NOPSI—Cecil Ex. 11
Test year revenue from testimony in L.P.S.C. Docket # U-i5689 ..... Tr. 174

24. NOPSI—Treich Ex. 12
From E.A. Cecil's Response to NOPSI Request Question #6, table 1 ..... Tr. 222

25. NOPSI—Cecil Ex. 13
Work papers produced by E.A. Cecil in response to Data Request Question #6, dated Feb. 27, 1986 ..... Tr. 231

26. NOPSI—Cunningham Ex. -14
White Bluff Capacity & Reserve Equalization Payments listing ..... Mar. 7: Tr. 7

27. NOPSI—Cunningham Ex. -15
MSU Systems Capability listing ..... Tr. 12

28. NOPSI—Jones Ex. -16
Rebuttal testimony ..... Tr. 34

29. NOPSI—Haneberg Ex. -17
Rebuttal testimony ..... Tr. 92

30. NOPSI—Phillips Ex. -18A
Prefiled testimony, 5/17/85 ..... Tr. 113

31. NOPSI—Phillips Ex. -18B
Prefiled testimony, 2/26/86 ..... Tr. 113

32. NOPSI—Phillips Ex. -19
Computation of margin of earnings of 12/85 ..... Tr. 161

33. NOPSI—Phillips Ex. -20
Computation of margin of earnings of 1/86 ..... Tr. 162

34. NOPSI—Palast Ex. -21
Comparison of NOPSI rates ..... Tr. 203

35. NOPSI—Palast Ex. -22
Rate comparison of 4/84 and 1/86 .. Tr. 206

36. NOPSI—Palast Ex. -23
Work papers: input-output model ... Tr. 225

37. NOPSI—Palast Ex. -24
Input-output model computer printout ..... Tr. 235

38. NOPSI—Clemente Ex. -25
Written Clemente testimony ..... Tr. 281

39. NOPSI—Ex. 26
Letter, to Clerk of Council L. Siegel, 12/16/85 ..... Tr. 404

40. NOPSI—Ex. 27
Attachment to Ltr of 12/16/85 (Memorandum) ..... Tr. 404

41. NOPSI—Ex. 28
Attachment to Ltr of 12/16/85 (Statement of Objections) ..... Tr. 404

42. NOPSI—Ex. 29
Letter of 2/14/86 to James M. Cain . Tr. 404

43. NOPSI—Ex. 30
Letter of 3/14/86 to Mr. Wruble ... Tr. 405

44. NOPSI—Ex. 31
Letter of 3/18/86 to Mr. Cain ..... Tr. 405

45. NOPSI—Ex. 32
Letter of 3/24/86 ..... Tr. 405

46. NOPSI—Ex. 33
Letter of 3/26/86 to Hon. Emma Williams ..... Tr. 405

47. NOPSI—Ex. 34
Letter of 3/24/86 to Mr. James Cain ..... Tr. 405

48. NOPSI—Cain Ex. 35
Prefiled testimony James M. Cain .. Tr. 467

49. NOPSI—Hurstell Ex. 36
Testimony 12/16/85 ..... Tr. 575

50. NOPSI—Hurstell Ex. 37
Rebuttal testimony 3/31/86 ..... Tr. 576

51. NOPSI—Lundberg Ex. 38
Deposition ..... Tr. 827

52. NOPSI—Trumps Ex. 39
Pre-filed direct testimony ..... Tr. 857

53. NOPSI—Ex. 40
Pre-filed rebuttal testimony ..... Tr. 857

54. NOPSI—Ex. 41
Exhibits 1, 2 and 3 ..... Tr. 857

55. NOPSI—Ex. 42
1979 Annual Report—Middle South Utilities ..... **Tr. 861

56. NOPSI—Louiselle Ex. 43
Prefiled testimony ..... Tr. 1095

57. NOPSI—Hendrie Ex. 44
Rebuttal testimony ..... Tr. 1252

58. NOPSI—Pearl Ex. 45
Direct testimony 12/16/85 ..... Tr. 1349

59. NOPSI—Ex. 46
Rebuttal testimony 3/31/86 ..... Tr. 1353

60. NOPSI—Ex. 47
FERC brief Docket #85-3654 .... Tr. 1435

61. NOPSI—Ex. 48
Letter from Councilman Giarrusso to Mr. Sexton 1/13/86 ..... Tr. 1448

62. NOPSI—Ex. 49
Letter to Councilman Giarrusso from P.G. Wright 4/3/86 ..... Tr. 1448

63. NOPSI—Komanoff Ex. 50
Read, signed & corrcted [*sic*] deposition ..... Tr. 1494

64. NOPSI—Hurstell Ex. 51
Speech in New Orleans, La. ..... Tr. 1604

65. NOPSI—Komanoff Ex. 52
Testimony before the Subcommittee on Energy & Environment 7/12/79 ..... **Tr. 1683

66. NOPSI—Mc Whinney Ex. 53
Prefiled testimony ..... Tr. 1705

67. NOPSI—McLetchie Ex. 54
Deposition dated 3/31/86 ..... Tr. 1916

68. NOPSI—Palast Ex. 55
Deposition dated 3/3/86 ..... Tr. 1916

69. NOPSI—Proffer of White testimony
To be submitted on latter date .... Tr. 1918

C. Exhibits: City of New Orleans

70. CNO—Ex. -1
Second data request to NOPSI #CNO-2-6 ..... Mar.4:Tr. 60

71. CNO—Ex. -2
White Bluff & reserve equalization payments July '85 through Feb. '86 ..... Tr. 74

72. CNO—Ex. -3
Filing by AP&L with S.E.C. Jan. 24, 1986 ..... Tr. 97

73. CNO—Ex. -4
AP&L settlement Sept. 5, 1985 ... Tr. 98

74. CNO—Ex. -5
Work papers of R.J. Abadie ..... Tr. 129

75. CNO—Ex. -6
Excerpt Electric Light & Power, Feb. '86, Vol. 64, No. 2 ..... Tr. 153

76. CNO—Ex. 6-A
Prepared direct testimony of R.W. Cuthbert Mar.5:Tr. 15

77. CNO—Ex. 6-B
(RWC-1) Record of Testimony & Regulatory Experience ..... Tr. 15

78. CNO—Ex. 6-C
(RWC-2) Cost of Capital Data ..... Tr. 15

79. CNO—Ex. 6-D
(RWC-3— Financial Data for MSU & Comparable Electric Utilities ..... Tr. 15

80. CNO—Ex. 6-E
(RWC-4) MSU's Cost of Equity Capital ..... Tr. 16

81. CNO—Ex. 6-F
(RWC-5) Financial data for NOPSI & MNU Operating Cos. ..... Tr. 16

82. CNO—Ex. 6-G
(RWC-6) NOPSI's Capitalization & Weighted Cost of Capital ..... Tr. 16

83. CNO—Ex. 7-A
Prepared direct testimony of E.A. Cecil ..... Tr. 112

84. CNO—Ex. 7-B
Exhibits to direct testimony of E.A. Cecil ..... Tr. 112

85. CNO—Ex. 7-C
Preliminary Analysis of Settlement Proposal of Testimony & Exhibits of NOPSI filed Feb. 5, 1986 ..... Tr. 112

86. CNO—Ex. 7-D
Corrected exhibit of E.A. Cecil previously marked 7-B ..... Tr. 128

87. CNO—Ex. -8
Prepared direct testimony of R.F. Camus ..... Tr. 197

88. CNO—Ex. -9
Request for production of data & documents of R.F. Camus on behalf of City of New Orleans .... Tr. 217

89. CNO—Ex. 10
Order on rehearing numbered U-15689-A Mar.7:Tr. 117

90. CNO—Ex. 11
Order Number U-16092-A ..... Tr. 119

91. CNO—Ex. 12
Solomon Bros. report of 1/6/86 ... Tr. 138

92. CNO—Ex. -13
Balance sheet of 12/31/84 ..... Tr. 150

93. CNO—Ex. -14
Balance sheet of 6/30/85 ..... Tr. 150

94. CNO—Ex. -15
Prefiled testimony of G.A. Palast .. Tr. 168

95. CNO—Ex. -16
Deposition of Mr. Carter ..... Tr. 413

96. CNO—Ex. -17
Deposition of Mr. Jung ..... Tr. 413

97. CNO—Ex. -18
Deposition of Mr. Brodtmann .... Tr. 413

98. CNO—Ex. -19
Deposition of Mr. Duncan ..... Tr. 413

99. CNO—Ex. -20
Deposition of Mr. Krebs ..... Tr. 413

100. CNO—Ex. -21
Deposition of Mr. Teamer ..... Tr. 413

101. CNO—Ex. -22
Deposition of Mr. Trumps ..... Tr. 413

102. CNO—Ex. -23
Deposition of Mr. Smallpage ..... Tr. 413

103. CNO—Ex. -24
Deposition of McLetchie ..... Tr. 413

104. CNO—Ex. -25
Deposition of Mr. Chavanne ..... Tr. 413
105. CNO—Ex. -26
Deposition of Mr. Talbot ..... Tr. 414
106. CNO—Ex. -27
Deposition of Mr. Wyatt ..... Tr. 414
107. CNO—Ex. -28
Deposition of Mr. Cain ..... Tr. 414
108. CNO—Ex. -29
Deposition of Mr. Hurstell ..... **Tr. 414
109. CNO—Ex. -30
System Agreement Filing
ER82483000 ..... Tr. 430
110. CNO—Ex. -30(a)
MLH Exhibit 5A ..... Tr. 437
111. CNO—Ex. -30(b)
Memorandum from E.A.
Louberger ..... Tr. 520
112. CNO—Ex. -30(c)
James M. Cain LPSC testimony ... Tr. 541
113. CNO—Ex. -31
Testimony J. Lundberg 3/19/86 ... Tr. 826
114. CNO—Ex. -32
Ltr. Congressman Markey
3/14/86 ..... Tr. 1155
115. CNO—Ex. -33
Testimony B.M. Louiselle 12/7/83
in Docket Nos. U15684 & U15689.
Pages 749–822 & 846–875 ..... Tr. 1177
116. CNO—Ex. -34
Cover page & Pages 7 & 8 of 1978
Licensing, Design & Construction
Problems report ..... Tr. 1305
117. CNO—Ex. -35
Testimony J.M. Hendrie before
New Hampshire Utilities
Commission ..... Tr. 1305

118. CNO—Ex. -36
Response to counsel data request
PD-11 ..... Tr. 1359
119. CNO—Ex. -37
Response to counsel date request
PD-13 ..... Tr. 1387
120. CNO—Ex. -38
C. Komanoff prefiled testimony &
attachments ..... Tr. 1460
121. CNO—Ex. -39
Book *Power Plant Cost Escalation*
by C. Komanoff published 1981 ... **Tr. 1566
122. CNO—Ex. -40
Compilations of Council, CNO
dated 3/19/86 ..... Tr. 1696
123. CNO—Ex. -41
Mooz report ..... Tr. 1809
124. CNO—Ex. -42
NOPSI Board of Directors minutes:
9/72–present ..... Tr. 1908
125. CNO—Ex. -43
Deposition of J. Cain in Civil
Action #85-5273 ..... Tr. 1909
126. CNO—Ex. -44
Deposition of E. Lupberger in Civil
Action #85-5273 ..... Tr. 1909
127. CNO—Ex. -45
Deposition of G. Palast; dtd:
March, 1986 ..... Tr. 1910

D. Transcripts

128. Tuesday, March 4, 1986. Pages 1–194
129. Wednesday, March 5, 1986. Pages
1–261
130. Friday, March 7, 1986. Pages 1–371

131. Tuesday, April 8, 1986. Pages 372–730
132. Wednesday, April 9, 1986. Pages 731–1246
133. Thursday, April 10, 1986. Pages 1247–1436.
134. Friday, April 11, 1986. Pages 1437—1700
135. Monday, April 14, 1986. Pages 1701–1924 and Pages 1–45

**1. Note: Exhibits identified in items 38, 55, 65, 108 and 121 were admitted with restrictions as set forth in the appropriate pages of the transcript.

Note: Transcript pages are numbered on a daily basis for March 4 and 5, and thereafter, consecutively commencing on Friday, March 7, 1986, except for new pages 1–45 as prepared for Monday, April 14, 1986.

I hereby certify that items 1 through 135 set forth above were adduced and compiled in the above captioned matter.

/s/ JOHN B. FARMAKIDES
John B. Farmakides
Hearing Officer

JOHN B. FARMAKIDES
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May 8, 1986

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P.O. Box 791169
New Orleans, Louisiana 70179-1169

Gentlemen:

Transmitted herewith is a copy of a memorandum for the record setting forth the matters discussed and actions taken during the telephone conference held on May 7, 1986.

Also please find a draft copy of an index of those items that will constitute the record in this proceeding. Please review the same and advise me, within 5 days, of any suggested corrections, amendments, etc. I will prepare and certify the final record as soon as possible thereafter.

Thank you for your cooperation.

Sincerely,

/s/ JOHN B. FARMAKIDES

Encls.

APPENDIX B

JOHN B. FARMAKIDES
ATTORNEY AT LAW
5835 UPTON STREET
MCLEAN, VIRGINIA 22101 (703) 241-0006

April 16, 1987

Honorable Joseph I. Giarrusso
Council President
New Orleans City Council
1300 Perdido Street
New Orleans, LA 70112

Re: Ex Parte Application of New Orleans Public Service Inc. for increase in Electric Rates, Docket No. CD-85-1

Dear Mr. Giarrusso:

This is to advise the City Council that the record has been completed in the above captioned matter to include, by direction of the City Council, the "remedy phase" of the said application.

The hearings were held in accordance with the schedule set by the Council. Thereafter, the parties were provided with reasonable time after receiving the final transcripts to review the same, submit any necessary corrections thereto, and file briefs. The Hearing Officer received a copy of the transcript for the final day of hearing on April 4, 1987.

A joint telephone conference with the parties was held on April 10, 1987, to discuss certain outstanding matters related to this proceeding as well as to the bond financing phase of the application. During that conference, the final record of this matter was closed as of April 10, 1987.

The attached certified index of the "remedy phase" to be included as part of the official record of the above captioned matter is hereby delivered to the City Council. It should be noted that the complete official record index of Docket No. CD-85-1 is composed of four segments, identified and forwarded by separate letters dated: May 6, 1986, February 12, 1987, April 10, 1987, and April 16, 1987. All four segments and all materials developed and compiled during the hearings have been delivered to the custody of the Clerk of the City Council.

Yours truly,

/S/ JOHN B. FARMAKIDES
Hearing Officer

Encl. as stated.

Before the
City Council of New Orleans

Matter of Ex Parte Application of New Orleans Public Service, Inc. for an Increase of Its Electric Rates. Doc. No. CD-85-1

The official *RECORD* of the above captioned matter, initially compiled as of May 7, 1986, is further augmented by Order of the City Council to include additional evidentiary material as set forth in items 1 through 67 below compiled as of April 10, 1987, as follows:

A. Application, and Procedural Documents

1. All materials previously included in the official record dated May 7, 1986.
2. All relevant Orders of the City Council, including those dated: May 20, 1986, July 7, 1986, July 30, 1986, August 29, 1986, December 2, 1986, and February 10, 1987.
3. Petition to intervene by the Attorney General of Louisiana dated October 22, 1986; approved by Res. R-87-10 of the City Council.
4. All materials previously included in the official record relating to the Tax Act Inquiry phase and the Financing Application phase of this Docket, submitted by letter dated February 12, 1987, and by letter dated April 10, 1987, respectively.,

B. Exhibits: New Orleans Public Service, Inc.

5. NOPSI—Excerpts City Council Hearing Ex. 57. Tr. 2195
6. NOPSI—Present Value Work Table Ex. 58
   (Grand Gulf Fuel Savings) ..... Tr. 2195

7. NOPSI—Excerpts City Council Hearing Ex. 59. Tr. 2197
8. NOPSI—G. Palast Ex. 60
   Deposition ..... Tr. 2315
9. NOPSI—G. Palast Ex. 61
   Response to data request from NOPSI ..... Tr. 2352
10. NOPSI—G. Palast Ex. 62
    Deposition ..... Tr. 2417
11. NOPSI—Eisenberg Ex. 63
    Deposition ..... Tr. 2465
12. NOPSI—A. Brimmer Ex. 64
    Pre-filed testimony ..... Tr. 2484
13. NOPSI—Barach Ex. 65
    Deposition--Oct. 17, 1986 ..... Tr. 2531
14. NOPSI—Hahne Ex. 66
    Rebuttal testimony ..... Tr. 2539
15. NOPSI—R.W. Jones Ex. 67
    Rebuttal testimony ..... Tr. 2704
16. NOPSI—R.W. Jones Ex. 68
    Deposition ..... Tr. 2704
17. NOPSI—Cunningham Ex. 69
    Rebuttal testimony ..... Tr. 2765
18. NOPSI—Cunningham Ex. 70
    Deposition ..... Tr. 2779
19. NOPSI—McLetchie Ex. 71
    Rebuttal Testimony..... Tr. 2844
20. NOPSI—McLetchie Ex. 72
    Deposition Volume I..... Tr. 2845
21. NOPSI—McLetchie Ex. 73
    Deposition Volume II ..... Tr. 2845
22. NOPSI—McLetchie Ex. 74
    Testimony ..... Tr. 2854
23. NOPSI—Palast Ex. 74A
    Letter to M. Caruso from G. Palast ..... Tr. 2852
24. NOPSI—Financial Model Run Ex. 75
    Run 10-B ..... Tr. 2871

25. NOPSI—Financial Model Run Ex. 76
Run 10-C New Tax Law ..... Tr. 2894
26. NOPSI—NOPSI Ex. 77
Response to City's Data Request #13 ..... Tr. 2899
27. NOPSI—Louiselle Ex. 78
Rebuttal testimony ..... Tr. 3008
28. NOPSI—Louiselle Ex. 79
Deposition Oct. 20, '86 ..... Tr. 3008
29. NOSPI—Louiselle Ex. 79A
Errata Sheet ..... Tr. 3008
30. NOPSI—Haneberg Ex. 80
Pre-filed testimony ..... Tr. 3035
31. NOSPI—Haneberg Ex. 81
Deposition 10/20/86 ..... Tr. 3035
32. NOSPI—Haneberg Ex. 82
Supplemental testimony data request ..... Tr. 3054
33. NOPSI—Marked Ex. 83
Spread Sheet ..... Tr. 3108
34. NOPSI—Marked Ex. 84
Louisiana Public Service Commission Order #15689 ..... Tr. 3108
35. NOPSI—Mc Letchie Ex. 85
Supplemental rebuttal testimony ..... Tr. 3133
36. NOPSI—Mc Letchie Ex. 86
Deposition with attached exhibits ..... Tr. 3134

C. Exhibits: City Council

37. CNO—NOPSI Computer Run Ex. 46
Computer Run 10-B Preferred Dividends. Tr. 1998
38. CNO—Cecil Ex. 47
Deposition ..... Tr. 1998
39. CNO—Haneberg Ex. 48
Testimony ..... Tr. 2220
40. CNO—Palast Ex. 49
Testimony & exhibits Sept. 1986 ..... Tr. 2308

41. CNO—Palast Ex.50
Rebuttal testimony Oct. 1986 ..... Tr.2308
42. CNO—Palast Ex.51
Deposition (see NOPSI EX. 60) Tr.2322
43. CNO—Palast Ex.52
Computer run Tr.2884
44. CNO—Hahne Ex.53
Deposition Tr.2544
45. CNO—DeLoitte Haskins & Sells Ex.54
(Unqualified) Auditors opinion Tr.2632
46. CNO—DeLoitte Haskins & Sells Ex.55
Inter-office memo Dated April 23, 1986 ..... Tr.2632
47. CNO—H. Abbott Ex.56
Letter April 18, 1986 ..... Tr.2632
48. CNO—NOPSI Ex.57
Excerpt 1985 Annual Report DHS Opinion 3-14-86 ..... Tr.2632
49. CNO-GAAS Guide Ex.58
Pages 8.49 & 8.50 ..... Tr.2632
50. CNO—NOPSI Ex.59
Excerpts from SEC Form 10Q for qt. ending 3/31/86 ..... Tr.2662
51. CNO—NOPSI Ex.60
Excerpts from SEC Form 10Q for qt. ending 6/30/86 ..... Tr.2662
52. CNO—NOPSI Ex.61
Form U-1, filed 9/23/86 ..... Tr.2662
53. CNO—Mc Letchie Ex.62
Work papers Tr.2979
54. CNO—Mc Letchie Ex.63
Work papers Tr.2979
55. CNO—Palast Ex.64
Errata sheet of deposition Tr.3003
56. CNO—G. Palast Ex.65
Pre-filed testimony Tr.3249
57. CNO—G. Palast Ex.65A
Work papers Tr.3249

58. CNO—G. Palast Ex. 66
    Deposition Feb. 20, 1987 ..... Tr. 3253
59. CNO—G. Palast Ex. 67
    Computer financial analysis ..... Tr. 3267
60. CNO—E. Cecil Ex. 68
    Pre-filed testimony ..... Tr. 3342

D. Exhibits: Citizens for Safe Energy (Intervenor)

61. SAFE—Eisengerg Ex. 3 (see footnote 2)
    Pre-filed testimony & exhibits ..... Tr. 2438
62. SAFE—Barach Ex. 4
    Pre-filed rebuttal testimony Oct. 10, 1986 ... Tr. 2522

E. Transcripts

63. Tuesday, October 21, 1986. Pages 1927–2226 and Pages 1–23
64. Wednesday, October 22, 1986. Pages 2227–2557
65. Thursday, October 23, 1986. Pages 2558–2878
66. Friday, October 24, 1986. Pages 2879–3120
67. Tuesday, February 24, 1987. Pages 3121–3420

F. Footnotes

Note #1. By agreement of the parties and the Hearing Officer, made during a joint telephone conference call on April 10, 1987, the final evidentiary record in the above captioned matter was closed as of that day, April 10, 1987, except as to certain matters related to the financing application phase of this proceeding. Those matters are noted in the separate record index of that phase submitted earlier by letter dated April 10, 1987.

Note #2. Exhibits No. #1 and No. #2 by the party Citizens for Safe Energy were marked but not offered or admitted into the record.

Note #3. The Attorney General for the State of Louisiana, admitted as a party Intervenor in the proceeding, did not present testimony or file exhibits to the record, but indicated an intention to file a post hearing brief. Such a brief was filed jointly with the other Intervenor, Citizens for Safe Energy.

Note #4. Docket No. CD-85-1 includes all evidentiary material relating to the Prudence and Remedy aspects of the inquiry, as well as to the Tax Act Inquiry phase and the Financing Application phase. For convenience, and by agreement of the parties, the last two phases were separately compiled and indexed.

I hereby certify that items 1 through 67 set forth above were adduced and compiled in the above captioned matter.

/s/ JOHN B FARMAKIDES
John B Farmakides
Hearing Officer

cc: All Council Members
Ms Emma Williams (Clerk of Council)
Brod Bagert, Esq.
Joseph Bernstein, Esq.
Mr. Gary L Groesch
Okla Jones III, Esq.
Thomas O Lind, Esq.
Mr. Kelly Meehan
Bruce Naccari, Esq.
Glen L Ortman, Esq.
Prof. Richard Pierce, Jr.
Warren M Schultz, Jr. Esq.
Mr. Jose Sierra
Alan C Wolf, Esq.
Bernhardt K Wruble, Esq.
Beverly Zervignon, Esq.

APPENDIX C

WITNESSES AND KEY INDIVIDUALS

Jeffrey A. Barach

Mr. Barach is a professor of Management at Tulane University. He began teaching at the University as an Assistant Professor in 1965, was an Associate Professor from 1968 to the end of 1985, and has been a full professor since that time. Mr. Barach's principal areas of concentration are: Business Policy; Business, Social and Individual Values; and Marketing, Advertising, Consumer Behavior, and Mass Communications. He has also held positions concurrent with his University post with several management consulting firms. Mr. Barach holds an A.B. from Harvard College and an M.B.A. and D.B.A. from the Harvard University Graduate School of Business Administration.

Andrew F. Brimmer

Mr. Brimmer is President of Brimmer and Company, Inc., an economic and financial consulting firm based in Washington. Mr. Brimmer holds a Ph.D. in economics from Harvard and has held various academic positions. Mr. Brimmer entered the government in 1963 as Deputy Assistant Secretary for Economic Policy Review for the U.S. Department of Commerce, he was later appointed by President Johnson to the position of Assistant Secretary for Economic Affairs. In 1966, he was appointed as a Member to the Board of Governors of the Federal Reserve Board. He left that position in 1974 and served as a Visiting Professor for two years in the Graduate School of Business Administration at Harvard University.

August J. Brodtmann

Mr. Brodtmann was employed by NOPSI from 1936 until his retirement in 1980. During his years at NOPSI, he served in various capacities such as Assistant to General Auditor, Manager

of property accounting, Assistant to Financial Vice President of NOPSI, Comptroller of NOPSI and Vice President of Finance of NOPSI. In addition, he served on the Middle South Finance Committee.

James M. Cain

Mr. Cain is presently President and Chief Executive Officer of both NOPSI (since 1978) and LP&L (since 1982). Beginning in 1978, Mr. Cain has served on the MSU, MSE, MSS and NOPSI Boards of Directors. Mr. Cain has been an employee of the Middle South System since 1960 when he started as a research assistant with NOPSI. He progressed through various jobs in NOPSI's Personnel Department, served as Vice President of personnel and Vice President of Administration. He then moved to MSS where he served as Executive Vice President and President from January 1975 to April 1978 before returning to NOPSI as president. Mr. Cain has both a Bachelor's and Master's Degree in Business Administration.

Fr. James C. Carter

Fr. Carter has been a member of the NOPSI Board of Directors since 1983. He is a Roman Catholic Priest and President of the Loyola University in New Orleans.

John H. Chavanne

Mr. Chavanne was employed by NOPSI from April 1966 until March 1985. He held various positions in the Methods & Procedures Department, was manager of the Budget & Statistical Department, served as Assistant Vice President of Finance, and Comptroller of NOPSI. In addition, Mr. Chavanne served as Vice President of Finance and Treasurer of NOPSI from November 1980 until consolidation of NOPSI and LP&L management. At that time he became Vice President of Corporate Control and Assistant Secretary of both NOPSI and LP&L. From November

1980 through November 1984, Mr. Chavanne regularly attended NOPSI Board meetings. He also served on Middle South System Finance Committee, Pension Plan Committee and Customer Information System Committee. Mr. Chavanne received his B.B.A., M.B.A. and J.D. from Loyola University in New Orleans. He is also a Certified Public Accountant.

Edward A. Cecil

Mr. Cecil is a partner in R.W. Beck and Associates, Engineers and Consultants, a national firm of engineers and consultants which provides services in areas such as design and construction engineering, environmental studies, power supply, power pooling, management systems, feasibility studies, systems engineering, and computer services. The firm has significant experience in the public utility field. Mr. Cecil has substantial experience in public utility matters, including rates, natural gas curtailment, power supply and resource planning and economic analyses. Mr. Cecil conducts a course on Electric Utility Retail Rate Design for the American Public Power Association. He has testified before a number of Federal and state regulatory commissions and courts. Mr. Cecil holds an A.B. and M.A. degrees from Colorado State University in Civil Engineering.

Shelton G. Cunningham

Mr. Cunningham became Senior Vice President for Marketing and Rates with Louisiana Power & Light Company (LP&L) and NOPSI in 1986. He began with LP&L in 1966 as a sales representative. In 1968 he became a rate analyst, was promoted to Rate Administration Manager in 1972, Assistant Director of Rates and Research in 1976 and Director in 1979. Mr. Cunningham was elected Vice President of Rates and Research in 1982 and supervised the functional consolidation of the Rate Departments of LP&L and NOPSI. Mr. Cunningham holds a B.S. degree in Mechanical Engineering from Mississippi State University and is a registered Professional Engineer in Louisiana.

Brooke Duncan

Mr. Duncan has served on the NOPSI Board of Directors since 1967. He also serves on the MSU Board of Directors. Mr. Duncan is the owner of a local awning manufacturing company and a wholesale hardware distribution company.

Theodore Eisenberg

Mr. Eisenberg is a Professor of Law at Cornell University who has taught a variety of courses including Debtor-Creditor Law, Civil Rights Legislation, Corporate Taxation and Individual Taxation. Mr. Eisenberg has been a professor since 1977 when he began teaching at UCLA. He has participated in the University of San Diego's summer program at Oxford, and as a Visiting Professor of Law at Harvard Law School.

Robert L. Hahne

Mr. Hahne is a certified public account and Partner in the firm of Deloitte Haskins & Sells (DH&S), a public accounting firm, and is responsible for their public utility industry practice. His duties at DH&S include coordination of the public utility audit, tax, and consulting efforts of the Firm's approximately 100 offices. Mr. Hahne is co-author of *Accounting for Public Utilities.* He has appeared as an expert witness in court, the Federal Energy Regulatory Commission, and numerous state regulatory commissions. Mr. Hahne holds a B.A. in Economics and Business Administration from Central Methodist College.

Ronald L. Haneberg

Mr. Haneberg has been a Consulting Actuary with Buck Consultants since 1977. He serves as NOPSI's Pension Plan actuary. Mr. Haneberg holds a B.A. in Mathematics and a J.D. from St. Louis University School of Law from which he graduated in 1969. Mr. Haneberg is a member of several Actuary organizations, as well as a member of the Missouri and American Bar Associations.

Joseph M. Hendrie

Dr. Hendrie is presently engaged in a private consulting engineering practice which provides services for private institutions and government agencies. He received his B.S. in physics from Case Institute of Technology and his PhD. in physics from Columbia University. He has worked at the Brookhaven National Laboratory where he performed research on nuclear power reactors, served as head of the Engineering Division, Department of Applied Science; Chairman, Department of Applied Science; Senior Scientist and Special Assistant to the Director. Dr. Hendrie served as Chairman of the Advisory Committee on Reactor Safeguards and Deputy Director, Technical Review of the Atomic Energy Commission, Directorate of Licensing. From August 1977 to June 1981 he served as Chairman, then Commissioner, then Chairman of the Nuclear Regulatory Commission.

Malcolm L. Hurstell

Mr. Hurstell is presently the Senior Vice President of Energy Delivery of NOPSI, responsible for executive management of System Engineering, Division Operations, and Consumer Services. Mr. Hurstell has been employed by NOPSI for approximately 37 years having served as the Senior Vice President and General Manager of NOPSI, responsible for the day-to-day operations of NOPSI; Vice President of Engineering and Production of NOPSI, responsible for operations of the Engineering, Electric Power and Energy Procurement Departments of NOPSI; Vice President of Engineering of NOPSI; and Manager of the Engineering Department of the Electric Systems Planning Division. During his NOPSI career he has served on the Middle South Operating Committee planning subcommittee and has been a member of the Middle South Operating Committee since 1975. In addition, Mr. Hurstell has been Senior Vice President of Energy Delivery of LP&L since February of 1985.

Robert W. Jones

Mr. Jones is a principal with Morgan Stanley & Company, Inc. specializing in public utilities, and as such has played a role in managing financial securities for NOPSI's parent company, public utility economics at GWU School of Government and Business Administration, lectured at public utility seminars sponsored by NARUC and the Canadian Bar Association, and coauthored a paper on rate design. In addition, he has testified in over 200 proceedings before several state regulatory proceedings, the FERC, and the Canadian National Energy Board.

Edwin Lupberger

Mr. Lupberger is the Chief Executive Officer of Middle South Utilities, Inc. Prior to his selection as CEO, Mr. Lupberger was Senior Vice President and Chief Financial Officer of Middle South Utilities, Middle South Services, Middle South Energy, and System Fuels, Inc.

Jack M. Lundberg

Mr. Lundberg is president of Lundberg, Marshall and Associates, Inc., a utility consulting firm which provides consulting services in such areas as generation and transmission system planning, financial feasibility studies and preliminary design and cost estimating. He received his B.S. in Electrical Engineering from the University of Wisconsin and a M.B.A. from New York University. Mr. Lundberg is a Professional Engineer in fourteen states and is a member of the Institute of Electrical and Electronics Engineers. He has been employed as an engineer for 23 years and has done extensive work in electric utility planning: while employed by American Electric Power Service Corporation, he participated in transmission planning, interconnection and pool-

ing studies; while employed by Stanley Consultants, he conducted generation, transmission and distribution planning studies for rural and municipal electric systems. While employed by R.W. Beck and Associates, he worked primarily on planning and analyses related to electric power supply arrangements, feasibility studies, economic analyses, contract negotiations and rate studies. Mr. Lundberg has testified on public utility matters before the Federal Energy Regulatory Commission, the Nuclear Regulatory Commission, and the state commissions of Colorado, Michigan, Minnesota, Missouri, New Mexico, Ohio and Texas.

Malcolm H. McLetchie

Mr. McLetchie is the Senior Vice President of Accounting & Finance, and Treasurer of both NOPSI and LP&L—a position he has held since 1984. His responsibilities include NOPSI's and LP&L's accounting and financial reporting as well as their financing programs. In addition, he makes presentations on the company's monthly financial operation at the respective Board of Directors meetings. Mr. McLetchie serves on the Middle South Finance Committee. Mr. McLetchie is a Certified Public Accountant who received his Bachelor Degree in Accounting from Wayne State University. He spent over 14 years in public accounting before joining MSS in 1977 as Assistant to the Vice President of Tax Services. He later became Director of Tax Services and then MSS Vice President of System Tax & Accounting.

Gregory A. Palast

Mr. Palast is a Senior Associate with Union Associates, a consulting firm. He has served as Executive Director of the New York State Legislature's Commission on Science and Technology, Economist to the State Assembly's Subcommittee on Public power and has taught economics at Indiana University. In addition, he serves as Consulting Economist to the Labor Coalition on Public Utilities, Chicago. Mr. Palast received his M.B.A. from the University of Chicago Graduate School of Business where he

specialized in Finance of Regulated Industries. Mr. Palast has testified before utility commissions and legislatures in approximately fifty proceedings on issues such as utility financial reorganization, rate of return, income tax accounting and other financial issues. He has studied, developed, and/or testified on plans to solve rate and financial problems posed by the addition of major generating plants. Such studies have included, among others, the Wolf Creek plant (Kansas), the Shoreham plan (New York), the Zimmer plant (Ohio), the Seabrook plant (Maine and New Hampshire) and the Limerick plant (Pennsylvania).

Lewis J. Perl

Dr. Perl is presently a Senior Vice President of the economic consulting firm of National Economic Research Associates, Inc. ("NERA"), specializing in the economics of energy and the environment. Dr. Perl received his B.S. in industrial and labor relations from Cornell University, his M.A. and PhD. in economics from the University of California at Berkeley. He has taught economics at Cornell University, School of Industrial Relations, and authored numerous economics papers which have been published in professional journals. In addition, he has presented testimony on the comparative cost of coal and nuclear generation before several state regulatory commissions as well as the Federal Energy Regulatory Commission and the Nuclear Regulatory Commission.

John B. Smallpage

Mr. Smallpage has been a member of the NOPSI Board of Directors since 1969. He is owner of Donovan Marine Inc. Mr. Smallpage received his B.S. in Engineering and M.B.A. from Tulane University.

William H. Talbot

Mr. Talbot is presently a Vice President, Assistant to the President and Secretary of NOPSI. He also serves as Secretary for the NOPSI Board of Directors; as secretary he is responsible for the

records of all board activities, preparation of the agenda for the board meetings and preparation of the minutes of the NOPSI board meetings.

Charles Teamer

Mr. Teamer has served on the NOPSI Board of Directors since 1978. He is the Vice President of Fiscal Affairs at Dillard University in New Orleans where he has been employed in various capacities for approximately 20 years. Mr. Teamer has a Bachelor Degree in Business Administration and has studied business and finance at several graduate schools.

Regis G. Trumps

As Vice President of System Planning and Forecasting at Middle South Services. Inc. ("MSS"), Mr. Trumps is in charge of the department responsible for assisting the Middle South operating companies in forecasting future electric demand and energy requirements on the Middle South system as well as developing long range expansion plans to accommodate the forecasted requirements. He has been an employee of the Middle South system for 29 years, having joined NOPSI in 1956. He has served as Manager of the electric system planning division of NOPSI, MSS Manager of System Planning, MSS Director of System Planning and Forecasting, and MSS Executive Director of System Planning and Forecasting. He has attended meetings of the Middle South Operating Committee ("MSOC") for over 15 years and served as Secretary of the MSOC from 1978-1984, August 1985 to date. Mr. Trumps graduated from the University of Southwestern Louisiana with a B.S. in Electrical Engineering and has done graduate work at Tulane University.

Robert T. McWhinney

Mr. McWhinney is presently a management consultant and a Director of Putnam, Hayes & Bartlett, Inc. (PHB), an economic and management consulting firm. Mr. McWhinney received his

B.S. in Engineering from the United States Naval Academy and his M.B.A. from Stanford University. During his tenure with the Navy, he served as a Nuclear Engineering Division officer and as the Polaris Weapons Officer. Subsequently, he was involved in establishing the Siting Office of the FERC's Energy Resource Development Program and the Safeguards Policy Office within the Regulatory Division of the Atomic Energy Commission. He was Operations Manager in the division of TRW, responsible for the technical consulting assistance TRW provided its energy clients, and later became Vice President and Director of Resource Planning Associates until its merger with PHB. Mr. McWhinney has provided testimony on the prudence of management decisions before the Federal Energy Regulatory Commission and the Texas Public Utilities Commission. He has authored a guide to strategic management published by the Edison Electric Institute.

Jack M. Wyatt

Mr. Wyatt presently serves on the Board of Directors of both NOPSI and LP&L. Mr. Wyatt is retired but has been employed by both LP&L and Systems Fuel Inc., another MSU subsidiary. He served as LP&L President from 1976 through 1982 and as LP&L Chairman of the Board from 1982 through 1983.

UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF LOUISIANA

NEW ORLEANS PUBLIC SERVICE INC.	CIVIL ACTION
VERSUS	No. 88-559
THE COUNCIL OF THE CITY OF NEW ORLEANS, *ET AL.*	SECTION "D" (2)

STATEMENT OF UNCONTESTED MATERIAL FACTS

Plaintiff, New Orleans Public Service Inc. ("NOPSI"), in support of its Motion for Summary Judgment submits that the following are uncontested material facts as to which there is no genuine issue to be tried:

1.

NOPSI is an investor-owned public utility organized and operated under the laws of the State of Louisiana and having its principal place of business in the City of New Orleans, State of Louisiana.

2.

The Council of the City of New Orleans (the "Council") is the legislative governing authority of the City of New Orleans (the "City"), a municipal corporation and political subdivision of the State of Louisiana. The Council exercises legislative power under a Home-Rule Charter, effective May 1, 1954. Pursuant to § 4-1604 of the Home-Rule Charter, as amended, the Council has regulatory jurisdiction over the intrastate retail sales of electricity by NOPSI within the City to the extent that such jurisdiction is not preempted or otherwise precluded by the United States Constitution, federal statutes, or actions of federal agencies.

3.

Defendants, Lambert Boissiere, Jr., Mike Early, Joseph I. Giarusso, Johnny Jackson, Jr., James Singleton, Dorothy Mae Taylor, and Peggy Wilson are individual members of the Council.

4.

The Middle South System ("Middle South System") consists of the parent holding company, Entergy, Inc. (formerly Middle South Utilities, Inc. or "MSU") and various direct and indirect subsidiaries, including, among others, a generating company, System Energy Resources, Inc. ("SERI"), and four operating utility companies, NOPSI, Louisiana Power & Light Company ("LP&L"), Arkansas Power and Light Company ("AP&L"), and Mississippi Power & Light Company ("MP&L"), sometimes referred to collectively as the "Operating Companies."

5.

Each of the Operating Companies is a "public utility" engaged in the production, interstate wholesale purchase and sale, and retail sale of electric power and energy in one or more of the states of Louisiana, Mississippi, Arkansas and Missouri.

6.

SERI (formed as Middle South Energy, Inc. or "MSE" in 1974) is the owner of a 90% interest in Unit No. 1 of the Grand Gulf Power Project ("Grant Gulf 1"), a nuclear powered generating facility located in Port Gibson, Mississippi.

7.

Grand Gulf 1 went into commercial operation on July 1, 1985, and generates power and energy exclusively for sale at wholesale in interstate commerce.

8.

In 1982, Middle South Services, Inc. ("MSS") filed with the FERC an agreement known as the 1982 System Agreement. The 1982 System Agreement was the subject of a proceeding before the FERC and was assigned FERC Docket No. ER 82-483-000. On February 4, 1985, FERC Administrative Law Judge Head issued an opinion in connection with this docket. *Middle South Services, Inc.*, 30 FERC (CCH) ¶ 63030 (February 4, 1985).

9.

In 1982, MSE filed with the FERC an agreement known as the Unit Power Sales Agreement or "UPSA." The UPSA was the subject of a proceeding before the FERC and was assigned FERC Docket No. ER 82-616-000. On February 3, 1984, FERC Administrative Law Judge Liebman issued a decision in connection with this docket. *Middle South Energy, Inc.*, 26 FERC (CCH) ¶ 63,044 (February 3, 1984).

10.

The City of New Orleans intervened and participated in the proceedings involved in FERC Docket Nos. ER 82-61-000 and ER 82-483-000.

11.

On June 13, 1985, the FERC issued its "Opinion and Order Setting Just, Reasonable and Non-Discriminatory Rates," *Middle South Energy, Inc.*, 31 FERC (CCH) ¶ 61,306 (June 13, 1985) ("Opinion No. 234"). Opinion No. 234 reviewed the decisions of the Administrative Law Judges in Docket Nos. ER 82-616-000 and ER 82-483-000.

12.

Among other things, FERC Opinion No. 234 allocated responsibility for SERI's 90% share of the costs, capacity, and energy of Grand Gulf 1 among the four Middle South operating companies as follows: AP&L 36%; LP&L 14%; MP&L 33%; and NOPSI 17%.

13.

In the FERC proceedings relating to Grand Gulf 1, the City of New Orleans advocated that NOPSI should not be allocated responsibility for more than 9% of the costs, capacity, and energy associated with Grand Gulf 1.

14.

In Opinion No. 234, the FERC held that the UPSA, modified as ordered in that opinion, would constitute the lawful federal rate schedule and allocation for the wholesale sale of electricity from Grand Gulf 1.

15.

On June 28, 1985, MSE filed with the FERC a revised UPSA in conformity with Opinion No. 234. Therefore, the FERC's allocation of responsibility for the cost, capacity, and energy of Grand Gulf 1 became operative on July 1, 1985, the date Grand Gulf 1 commenced commercial operations.

16.

On October 17, 1985, the Council adopted Resolution No. R-85-636 by which it initiated its inquiry into the prudence of NOPSI's involvement in Grand Gulf 1. The Council thereafter conducted a prudence inquiry to which it assigned Docket No. C.D. 85-1.

17.

In March 1986, the Council and NOPSI reached a partial settlement of their differences with respect to Grand Gulf 1, which settlement was embodied in Council Resolution No. R-86-112. In this settlement, among other things, NOPSI agreed permanently to absorb $51.2 million dollars of its FERC-allocated Grand Gulf 1 costs. In this resolution, the Council also provided for the phase-in of Grand Gulf 1 costs, as well as the allocation of such costs among customer classes.

18.

On February 4, 1988, the Council adopted its Resolution No. R-88-14 and the accompanying "Determinations and Order Regarding the Prudence of the Management of New Orleans Public Service Inc. with Respect to Grand Gulf 1" ("Rate Order"). Resolution No. R-88-14 and the "Rate Order" constitute the Council's determinations and findings with respect to its prudence investigation of NOPSI's involvement in Grand Gulf 1.

19.

In the Rate Order, among other things, the Council required NOPSI to write-off of $135 million of its previously deferred Grand Gulf 1 costs in addition to the $51.2 million dollars of Grand Gulf 1 cost that NOPSI had already agreed to absorb in its settlement with the City.

20.

The FERC found that the Middle South System constituted a highly coordinated, integrated electric system. 31 FERC (CCH) ¶ 61,305 at 61,645.

21.

The FERC found that the Grand Gulf 1 nuclear power plant was planned to meet the overall needs and objectives of the Middle South System. 31 FERC (CCH) ¶ 61,305 at 61,653, 61,655.

22.

On September 17, 1980, NOPSI's president, Mr. James Cain, testified before the Council in connection with NOPSI's application for a "capacity adjustment clause" to its retail rates schedule. Mr. Cain gave the following testimony:

> If it is in the wisdom of this Council that it is not appropriate for New Orleans Public Service to participate in this agreement, which they will reflect on through either approval or disapproval of the capacity adjustment clause, through the

> approval or disapproval of any rate relief we seek as per Grand Gulf, then NOPSI has the option of selling the capacity and marketing it which, we think will be a very attractive commodity to other electric utilities who will view this as very, cheap, reliable power for the future.
>
> (Transcript of September 17, 1980 hearing at 547; *see* Council's Order at 96.)

23.

Mr. Jack Lundberg, one of the consultants retained by the Council in connection with its prudence inquiry, testified that, in his opinion, Mr. Cain was engaging in "wishful thinking" when he testified in 1980 that NOPSI would have been able to complete a sale of Grand Gulf 1 power to another public utility. Mr. Lundberg's testimony was as follows:

> Q. Mr. Lundberg, do you recall a quote that we have dealt with before by Mr. Cain in 1980 having to do with the salability of power from Grand Gulf?
>
> A. Yes, sir.
>
> Q. At that time?
>
> A. Yes, sir.
>
> Q. Do you recall that Mr. Cain said that it was his view at that time that he could sell that power because it would be, he would have the option to sell it, because he thought it would be a very attractive commodity to other electric utilities who will view it as very cheap reliable power for the future?
>
> A. Right. I recall that statement.
>
> Q. Isn't it your view, sir, that you consider Mr. Cain to have been a wishful thinker to have made that statement?
>
> A. That appears in my deposition, yes.
>
> Q. That is your position?
>
> A. Right.
>
> (Hearing Transcript, pp. 976-77.)

24.

In March of 1982, MSS attempted to sell power from Grand Gulf 1 by offering it to 57 different prospective purchasers. (NOPSI Exhibit 36. *See* Council's Order at 105.) MSS did not receive a single positive response.

25.

The Council stated in its Order that it did not base its decision on the statements made in 1980 by Mr. Cain or NOPSI's other officers. (Council's Order at 170.)

26.

Mr. Charles Komanoff, another consultant retained by the Council in connection with its prudence inquiry, testified that because of certain "intangibles," in order for NOPSI to have made an off-system sale of Grand Gulf 1 capacity, the price would have had to be below the cost of coal power. Mr. Komanoff testified as follows:

> Q. I'm not trying to tell you what, you know, use your standard for what's a prudent buyer, but once you have a prudent buyer with equal access to the coal power from AP&L as NOPSI, when NOPSI would want to sell its interest in Grand Gulf to that buyer, doesn't it have to at least match the price of the coal from AP&L?
>
> A. Well, I think the assumptions in the question have created an identity between NOPSI and the buyer in that their cost of the coal option is identical and their perception of the cost of Grand Gulf is identical, and under that circumstance, NOPSI would have to indeed discount Grand Gulf to a point such that both NOPSI and its buyer would each individually be indifferent on a cost per kilowatt-hour projection indifferent between having Grand Gulf and having the coal-fired capacity and, in fact, I've estimated that discount and believe that it's on the order or [*sic*] about a 50 percent discount and in the sunk cost to achieve the—

> Q. Price parity, price equality?
>
> A. Price parity, yes, thank you.
>
> Q. Okay. So in that situation, with that kind of a buyer, NOPSI doesn't—this maneuver by NOPSI doesn't save any money, does it?
>
> A. That's right, it doesn't make NOPSI's projected generating costs any less than it would be without the deal.
>
> Now, there are these other criteria that I consider important, the so-called intangibles, such as risk, and managerial intention, by your assumption probably would extend to cover those as well so that the management of this other utility feels the same way about the so-called intangible factors as NOPSI does.
>
> * * *
>
> Q. So taking the situation that we've been talking about and factoring in those intangibles, wouldn't that mean that the discount on the nuclear power from Grand Gulf would actually have to be equal to a price below the cost of power from AP&L, coal power from AP&L?
>
> A. If the buyer, if the potential buyer, who had access to both NOPSI's Grand Gulf and NOPSI's coal optioned that view of the intangibles, which I feel a prudent buyer should have had, then the answer is yes.

(NOPSI Exhibit 50, pp. 82-84.)

27.

The United States Court of Appeals for the District of Columbia observed: "When the UPSA was negotiated in 1979, Grand Gulf capacity appeared to be a good buy. . . . It seems unlikely that, in 1979, the Middle South operating companies could have foreseen that the cost of completing Grand Gulf would quadruple because of the lengthy regulatory delays that would occur in the aftermath of the Three Mile Island accident." *Mississippi Industries V. FERC,* 808 F.2d 1525, 1555 (D.C. Cir. 1987).

28.

With respect to the generation additions to the Middle South System, the FERC stated: "that if a [generation] unit is built to meet overall system goals, then the individual companies would benefit from that unit either directly or indirectly." Opinion No. 234-A, 32 FERC (CCH) at 61,958.

29.

In the 1982 System Agreement proceeding, Administrative Law Judge Head recognized that NOPSI was scheduled to own 10% of each of two 800 megawatt coal-fired units planned to be constructed by LP&L at Wilton, Louisiana. *Middle South Services, Inc.*, 30 FERC (CCH) at 65,145.

30.

In the 1982 System Agreement, the Middle South System had a stated objective of moving toward coal and nuclear generation. The FERC specifically found this goal of the Middle South System to be reasonable. Opinion No. 234, 31 FERC (CCH) at 61,656.

31.

The FERC implicitly accepted the uncontroverted testimony of MSU executives who explained why they believed the decision to construct and complete Grand Gulf 1 was sound, and approved the finding that continuing construction of Grand Gulf Unit No. 1 was prudent because Middle South's executives believed Grand Gulf 1 would enable the Middle South System to diversify its base load fuel mix and, it was projected, at the same time, produce power for a total cost that would be less than existing alternatives on the System. *See New Orleans Public Service, Inc. v. Council of City of New Orleans,* 109 S.Ct. 2506, 2510-11 (1989); *Mississippi Power & Light Co. v. Mississippi ex rel. Pittman,* 108 S.Ct. 2428, 2434 (1988).

32.

The incident at the Three Mile Island nuclear facility occurred on March 28, 1979.

33.

By the end of March, 1979, the construction on Grand Gulf 1 was over 70% complete.

34.

In his testimony, Charles Komanoff advocated use of a methodology of cost estimation known as "regression analysis." Mr. Komanoff testified that such methodology was not widely used in the estimation of nuclear power plant costs:

A. What you're saying, then, sir, is the methodology wasn't being used at all in the industry.

MR. WRUBLE:

That's exactly—I object to the form of the question, exactly contradictory to the testimony.

THE COURT:

I would like to hear the response to that question.

Mr. Komanoff, could you respond to it? Explain your response.

THE WITNESS:

Yes, The methodology did not have widespread use in the area of nuclear plant costs in 1979.

* * *

Q. You're not just saying it would have been prudent to apply the tool, you're going a step further and saying it was imprudent not to apply the tool.

A. I am saying that, yes, sir.

Q. Notwithstanding the fact it was not in widespread use in estimating capital costs of nuclear power plants.

A. That's correct.

(Hearing Transcript, pp. 1647-48, 1651.)

35.

In his testimony Mr. Komanoff stated that he was the first person to apply the regression analysis methodology to a current comprehensive comparison of nuclear and coal power. Mr. Komanoff gave the following testimony:

THE COURT:

So you were the third person involved in this arena?

THE WITNESS:

Yes, sir.

But the first to apply a current, at least as of the 70s or late 70s, a current comprehensive comparison of nuclear and coal and then to put that to different regulatory factors.

(Hearing Transcript, pp. 1652-53.)

36.

Mr. Komanoff's methodology was first published in 1981 in his book "Power Plant Cost Escalation." (CNO Exhibit 39.)

37.

At the beginning of his book, in 1981, Mr. Komanoff wrote the following:

The conclusions of this book differ radically from the views generally held within the federal government, the electric power industry (utilities, reactor vendors and architect-engineers), and the technical and policy communities.

(CNO Exhibit 39 at 1.)

38.

Mr. Komanoff testified as follows:

Q. The way to put it, then, sir, would be that your testimony here is that you find NOPSI to have been imprudent in 1979 for failing to reach conclusions that differed radically from the views generally held within the Federal Government, the electric power industry, and the technical and policy communities, is that correct?

A. *Un, I would—I would almost say—I would say instead that I would hold NOPSI imprudent for failing to apply a method to which had it been applied would have led to conclusions that did differ radically from those prevailing opinions.*

(Hearing Transcript, p. 1655 (emphasis added).)

39.

Mr. Komanoff testified that, as of 1979, the results from the application of the regression analysis methodology to estimate the cost to build and operate Grand Gulf 1 should have been adjusted upward to take account of the effect of the Three Mile Island incident that occurred on March 28, 1979. Specifically, Mr. Komanoff testified that the results of the regression analysis methodology should have been increased by 25 percent in the categories of original capital cost and property tax and insurance; and should have been increased by 20 percent with respect to capital additions and station operation and maintenance costs. (Hearing Transcript, pp. 1537-39.)

40.

In his testimony, Mr. Komanoff testified that the percentage increases that he applied to take account of the Three Mile Island incident constituted a judgment figure and were not based upon any formula. His testimony was as follows:

"The 25 percent increase is my reconstruction of a judgment figure I would have considered prudent at the time. TMI was unprecedented and a watershed event. *Neither I, nor anyone else, had a formula for estimating its effect on reactor costs.*

(CNO Exhibit 38, p. 68 (emphasis added).)

41.

Regarding the appropriateness of the 20 percent and 25 percent increases to take account of the Three Mile Island incident, Mr. Komanoff testified that lower percentages could have appropriately been used:

Q. I think you have explained that, sir. I'm just asking you to confirm, for the purpose of what we're doing here

today, that under a range of analyses that might have taken place in 1979, you would have considered that range to have been appropriate, starting at 10 percent, and then working on up to some higher figures beyond that. Isn't that correct?

A. To some much higher figures, yes, sir.

(Hearing Transcript, p. 1544.)

42.

The Council's Order does not identify any potential purchaser of NOPSI's share of Grand Gulf power and capacity in 1979 or 1980.

43.

The Council's Order does not identify a specific off-system source of coal-fired generation from which NOPSI should have purchased coal-fired capacity.

44.

Mr. Komanoff acknowledged in his testimony that if NOPSI had attempted to sell its allocation of the power from Grand Gulf 1 in 1979, and if prospective purchasers were aware that the coal alternative appeared to be cheaper, and the prospective purchasers had access to the coal alternative, then NOPSI would have been required to offer Grand Gulf power at a discount price that was actually below the cost of power from the coal alternative. In fact, in Mr. Komanoff's view, under such circumstances, the price of power from Grand Gulf would have had to have been discounted to approximately 10% less than the lifetime cost of the coal-fired alternative in order for a prospective purchaser to agree to buy such Grand Gulf capacity. In this regard, Mr. Komanoff testified as follows:

Q. When you include the intangibles, and you're talking about the intangibles near the end of your testimony where you said if price is equal between coal and nuclear from Grand Gulf, coal should be preferred?

A. Yes.

Q. So taking the situation that we've been talking about and factoring in those intangibles, wouldn't that mean that the discount on the nuclear power from Grand Gulf would actually have to be equal to a price below the cost of Power from AP&L, coal power from AP&L?

A. If the buyer, if the potential buyer, who had access to both NOPSI's Grand Gulf and NOPSI's coal optioned that view of the intangibles, which I feel a prudented [sic] buyer should have had, then the answer is yes.

Q. Can you express the value of the discount attributable to those intangibles under the circumstances of the sale that we've been discussing?

A. I think I did that implicitly earlier when I said that for NOPSI, if the projected nuclear to coal or Grand Gulf to coal lifetime cost ratio went down to around .9, then NOPSI might just as well have held onto a considerable part of Grand Gulf and there is about a two to one ratio.

I guess in these prospective calculations in '79, the capital charges were or the sunk capital charges are about half of the total life-cycle costs for Grand Gulf. So to go down to .9—

Q. We can work out the conversion later.

What you're saying is that the discount for the intangibles is worth about 10 percent of lifetime costs?

A. Yes.

(NOPSI Exhibit 50, pp. 84-85.)

45.

Mr. Komanoff further testified that if NOPSI made a discount sale of its Grand Gulf 1 allocation, coupled with the purchase of a replacement from a coal-fired alternative, the net effect would be to increase NOPSI's expected generation costs above that which it would have expected from Grand Gulf 1 alone. Mr. Komanoff testified as follows:

Q. I want to go back a minute to the subject of a sale of NOPSI's interest to the discount. Now, in the situation

that I asked you to assume where the discount actually had to go below the cost of coal because the buyer was as well informed as NOPSI was, and the intangible factor about nuclear going below the cost of coal, in that situation what's going to happen to NOPSI's total cost for the energy that it eventually buys from AP&L?

A. So, again, the hypothesis is that for reasons we've gone over, and I don't have to repeat, the buyer insists on a price for Grand Gulf that brings the buyer's expected Grand Gulf generation costs below the buyer's expected coal generation costs and in that circumstance, NOPSI's expected generation costs would be greater than those it would have expected from Grand Gulf.

Q. In that case its total cost actually goes up over that stating Grand Gulf?

A. That is correct.

(NOPSI Exhibit 50, pp. 122-23.)

46.

Neither the Council, nor any witness in the Council's prudence inquiry, ever proposed exactly how the transactions comprising the sell-off option would have been structured.

47.

On July 17, 1985, the Council adopted its Resolution No. R-85-423.

48.

On February 6, 1986, the Council passed its Resolution No. R-86-43. In this resolution, among other things, the Council prohibited the hearing examiner from issuing proposed findings of fact and conclusions of law.

49.

Nowhere in the Council's Order did the Council contend or find that the FERC's allocation of Grand Gulf 1 capacity to NOPSI resulted in NOPSI's having excess generating capacity.

50.

In the 1980 Memorandum of Understanding, AP&L agreed to take a 0% allocation of Grand Gulf capacity and energy.

51.

In the 1970's and 1980's, AP&L constructed four coal-fired generation units, two at Independence, Arkansas and two at White Bluff, Arkansas.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, the undersigned, hereby certify that I have on this 12th day of September, 1989, served a copy of the foregoing pleading on counsel for all parties to this proceeding by sending same by Federal Express to counsel outside New Orleans, and by hand delivery to New Orleans counsel.

/s/ HERSCHEL L. ABBOTT, JR.

UNITED STATES DISTRICT COURT
FOR THE
EASTERN DISTRICT OF LOUISIANA

NEW ORLEANS PUBLIC SERVICE, INC. Plaintiff v. THE COUNCIL OF THE CITY OF NEW ORLEANS, JOSEPH I. GIARRUSSO, LAMBERT C. BOISSIERE, JR., MIKE EARLY, JOHNNY JACKSON, JR., JAMES SINGLETON, DOROTHY MAE TAYLOR AND PEGGY WILSON Defendants	Civil Action No. 88-559 Section D Magistrate: (4)

DEFENDANTS' RESPONSE TO "STATEMENT OF UNCONTESTED MATERIAL FACTS"

This response is submitted by the Council of the City of New Orleans, *et al.* ("the Council"), in answer to the "Statement of Uncontested Material Facts" ("the Statement") submitted on September 12, 1989 by plaintiff New Orleans Public Service Inc. ("NOPSI").

INTRODUCTION

In its "Memorandum in Support of Motion for Summary Judgment," NOPSI posits that there are no facts in dispute and that this Court can resolve NOPSI's claims "on the face of the Council's Order *and* in the record created by the Council." NOPSI Mem. at 4 (emphasis added)—thus conceding that review of the administrative record is necessary for resolution of this case. Such review is required by the United States Supreme Court's decision, which rejected NOPSI's facial or "conceptual" preemption chal-

lenges, and held that the only remaining inquiry concerned whether the evidentiary record supported the Council's findings, a matter which, it said, "requires further *factual* inquiry." ***NOPSI v. Council of New Orleans***, 109 S. Ct. 2506, 2517 (1989) (emphasis added).

In its Statement, NOPSI does not present matters that are uncontested. Rather, it quotes selectively excerpts from the administrative record in an effort to counter the evidence relied upon in the Rate Order. However, NOPSI's extracts from the record are often incomplete, misleading, and irrelevant. Notably, NOPSI fails to point to *any* evidence that *it* presented in the prudence hearing as "uncontested" on the central issue of whether NOPSI bypassed an opportunity to sell. NOPSI seeks only to contest the evidence on which the Council relied. On summary judgment, that evidence, of course, must be taken as true and all favorable inferences afforded to it.

In certain cases below where NOPSI's record excerpts are incomplete and misleading, the Council has set forth, in context, the full excerpt, with the portion omitted by NOPSI in bold print.

Response to Particular Statements

1. Paragraph 1 is admitted, with the qualification that it omits the terms and conditions under which NOPSI is permitted to serve the New Orleans ratepayers. On April 21, 1922 the Commission Council (the Council's predecessor) enacted Ordinance No. 6822, specifying the conditions under which NOPSI was to be enfranchised, which included, *inter alia*, that NOPSI "be efficiently and economically managed and operated." § 2, Ord. No. 6822. Ordinance No. 7068 officially enfranchised NOPSI, provided that it would collect only "such fair and reasonable rates for electrical energy furnished and delivered in the City of New Orleans as may be established by the City of New Orleans . . . ." § 4, Or. No. 7068. These matters are described more fully in the Rate Order at pages 1–3.

2. Paragraph 2 is incomplete in that it does not mention that the Council's regulatory authority over NOPSI is recognized in the Louisiana Constitution of 1974. It is inaccurate in that Home Rule Charter Section 4-1604 grants the Council "all powers of supervision, regulation, and control" over NOPSI, and does not limit the authority to "intrastate" rates. The Council, as for all state commissions, has exclusive power to regulate all retail sales (sales to ultimate consumers), whether they are intrastate or interstate. *Panhandle Eastern Pipe Line Co. v. Pub. Serv. Comm'n*, 332 U.S. 507, 514 (1947). Further, it is tendentious in that there is nothing in the Home Rule Charter or Louisiana Constitution delineating limits on the Council's authority under federal law, and no limit has been exceeded in this case.

3. Paragraph 3 is admitted.

4. Paragraph 4 is admitted, with the addition that System Energy Resources, Inc. (SERI) was previously known as Middle South Energy, Inc. (MSE).

5. Paragraph 5 is admitted, except that it is believed that NOPSI is not ordinarily engaged in interstate, wholesale sales of electric power and energy.

6. Paragraph 6 is admitted.

7. Paragraph 7 is admitted.

8. Paragraph 8 is admitted.

9. Paragraph 9 is admitted.

10. Paragraph 10 is admitted, but it is incomplete. The Council began its participation in the FERC proceedings late and only after reacquiring regulatory authority over NOPSI pursuant to a public referendum. Based in part on statements made by NOPSI in a 1980 hearing before the Council, the Council had in 1981 relinquished its retail rate authority to the Louisiana Public Serv-

ice Commission ("LPSC"). After it became apparent that the LPSC was not fully representing New Orleans, a referendum was held, jurisdiction was returned to the Council, and the Council intervened in the FERC proceeding. *See* Rate Order at 2 n.l. (NOPSI did not, as an individual company, participate in the FERC proceedings until *after* the close of the evidentiary record.)

11. Paragraph 11 is admitted.

12. Paragraph 12 is admitted.

13. Paragraph 13 is admitted, except it is incomplete. In 1980, after the Three Mile Island incident and with costs rising, NOPSI inexplicably agreed to take a disproportionately large 29.8% share of Grand Gulf 1 (and acceded to AP&L's receiving a zero allocation); and the Middle South System proposed in the FERC, with no objection from NOPSI, that NOPSI should receive such 29.8% share of Grand Gulf 1. The Commission rejected the arrangement and reduced NOPSI's share to 17%.

14. Paragraph 14 is admitted.

15. Paragraph 15 is admitted, with the qualification that the FERC's allocation concerned only interstate wholesale rates.

16. Paragraph 16 is admitted, except that the Council adopted Resolution No. R-85-636 on October 10, 1985.

17. Paragraph 17 is admitted, except that it is incomplete. The settlement provided for the phase-in of Grand Gulf costs over an approximate 12-year period, with annual rate increases limited to six percent, so as to moderate "rate shock" and avoid the immediate 60 (and perhaps larger) percent rate increase sought by NOPSI in this Court in *NOPSI I*. The settlement also provided that it did not limit the Council's right to conduct a prudence investigation, stating in paragraph 26:

> THE COUNCIL IS NOT REQUIRED TO CEASE ITS INQUIRY INTO THE PRUDENCE OF NOPSI'S IN-

> VOLVEMENT IN GRAND GULF OR TO REFRAIN FROM ISSUING ORDERS WITH RESPECT THERETO, UNLESS SO ORDERED BY A COURT OF COMPETENT JURISDICTION.

18. Paragraph 18 is admitted.

19. Paragraph 19 is admitted.

20. Paragraph 20 is admitted, though the adjectives used there to describe the "system" do not provide a clear or accurate portrayal of the "system's" functions and limitations. For example, each generating plant on the "system" has been owned by an operating company individually, with the exception of Grand Gulf, which is owned by a separate company. Each operating company's individual decision in building or contending for power sources has principally determined *its* costs and rates, and there is, and has been, a significant disparity in total power costs among the operating companies (and NOPSI's cost has been the highest over the last 20 years). These matters are described in the Rate Order at pages 51-71.

Moreover, in a recent proceeding before the FERC, the "system" stated, *inter alia*, that: (1) "the FERC has never ruled in Opinion 234 or anywhere else that SERI and the [operating companies] are not separate economic entities"; and (2) under the Public Utility Holding Company Act ("PUHCA") " 'each company in a registered system is, in important respects, expected and required to be a separate economic entity.' " Initial Brief of System Energy Resources, Inc. and the System Operating Companies at 45-47, *System Energy Resources, Inc.*, No. FA86-19-002 (Feb. 7, 1989).

21. Paragraph 21 is admitted.

22. Paragraph 22 is admitted, but it is incomplete. NOPSI omits to state that Mr. Cain twice stated before the Council that

off-system sales were available to NOPSI. Omitted is Mr. Cain's statement that:

> the Council has the option either to approve our participation in this project through the capacity adjustment clause, and if subsequently it does not then and we file a rate case and they say, 'No, we are not going to allow the recovery of any rates to recover those expenses,' then that's it. They have made the judgment that New Orleans Public Service should not participate in this unit. *And then we will have the option of selling this unit and our portion of it to some other buyer.*

NOPSI Rate Hearing Tr. at 560-61 (Sept. 17, 1980) (emphasis added), *cited in* Rate Order at 96.

NOPSI also fails to explain the context and importance of the statement, which was made by Mr. Cain in conjunction with a NOPSI proposal at the 1980 hearings for a "capacity adjustment clause." This clause would have allowed NOPSI, in advance, an automatic and full pass-through of all Grand Gulf costs, without further regulatory review. NOPSI was pressing for such a clause while it was actively portraying Grand Gulf as a substantial "benefit" to the New Orleans ratepayers, "after everyone [at Middle South] realized what the cost of the unit was going to be," as stated by NOPSI's own expert. Rate Order at 164. NOPSI's misleading testimony in 1980 covered up the need for further inquiry and action and created the very problems of proof as to available options upon which NOPSI seeks to rely in this proceeding.

23. Paragraph 23 is incomplete and misleading. While it refers to the deposition testimony of Mr. Lundberg, it does not recite it. Mr. Lundberg's "wishful thinking" characterization refers to his belief that if Mr. Cain chose to characterize the Grand Gulf 1 power as "a very attractive commodity" (as opposed to "moderately competitive") and if NOPSI held on to the power until the plant was completed and sought to sell it without a discount, it

would be wishful thinking. The relevant portion of the deposition transcript is as follows:

> Q. What do you think is not reasonable about that [Mr. Cain's] statement?
>
> A. Very attractive commodity, I question whether a prudent analyst would have still felt it was very attractive. Maybe it remained moderately competitive. Very attractive sounds a little excessive. Very cheap sounds a little bit untrue. Reliable, with an uncompleted nuclear plant pushing into the threshold of a new design areas [*sic*], sounds a little questionable.
>
> Those things just seem a little bit excessive. A prudent analyst probably would not have been so bold at that point.
>
> Q. Would you agree with his statement that NOPSI has the option of selling the capacity?
>
> A. NOPSI given a completed plant presumably would have the option of selling it.
>
> Q. On the basis that it would be sufficiently attractive and sufficiently cheap to be power that purchasers would prefer over power from other sources such as coal or oil?
>
> A. They would prefer if it were priced at a level competitive. The alternatives, probably at this point, it should become apparent they should discount it to make it competitive.
>
> Q. You think if he is making the statement in the belief he would not have to sell at a loss; you would consider him to be incorrect at that point?
>
> A. I would consider him to be a wishful thinker.

NOPSI Exh. 38 at 157-158.

24. Paragraph 24 is materially incomplete. MSS attempted as agent for the operating companies to sell off Grand Gulf power. NOPSI fails to state that the projected costs of Grand Gulf in 1982 were nearly double those prevailing in the 1979-80 period, so that in 1982 there were, expectably, no takers. Rate Order at 169; Tr. 795; CNO Exh. 29 at 142-49. (The significance of this attempted sell-off was that it shows the operating companies thought it was *feasible* to sell off a portion of Grand Gulf and that they had some *obligation* to attempt to do so.)

25. Paragraph 25 is denied. NOPSI misstates the Council's position, because the context, not revealed by NOPSI, was whether an estoppel rule should be applied. The Council stated that in view of President Cain's statements NOPSI *should* be equitably estopped from denying the feasibility of off-system sales, but that it was not relying on such estoppel principles. *See* Rate Order at 170-71. The Council relied on evidence in the record that such sales were feasible, and such evidence *included,* but was not limited to, Mr. Cain's statements. (See the accompanying memorandum of law.)

26. Paragraph 26 is denied. The portion of the transcript quoted by NOPSI relates only to an unreal, hypothetical situation posed to Mr. Komanoff by NOPSI's attorneys based upon certain assumptions, some of which are noted in the answer. This hypothetical situation posited that NOPSI would sell its power to a utility that was substantially *identical* to NOPSI, having the same fuel diversification situation as NOPSI, equal access to coal at the same price as NOPSI, and the same information with respect to, and perception ~~of,~~ Grand Gulf's economics as NOPSI. Mr. Komanoff testified that under these assumptions, NOPSI would have had to discount its sale of Grand Gulf power. (*See* NOPSI Exh. 50 at 81-86.)

NOPSI never sought to show that such a contrived situation actually existed in the marketplace. Ordinarily, the ability to buy

and sell power in the marketplace depends on the differing situations and needs of the market participants, as Mr. Komanoff testified.

27. Paragraph 27 is admitted insofar as the quoted excerpt is accurate, but it is incomplete, misleading and addresses a different issue. The statement, couched in terms as "it seems" and it "appeared," are not "findings." What was foreseeable in 1979 and in 1980 was *not* at issue in the FERC proceedings. In contrast, cost projections at those dates were both litigated and relevant in the Council's prudence proceedings to determine NOPSI's conduct with respect to its retail obligations (not with respect to construction of the plant, the very different issue commented on by the FERC). Moreover, the FERC defined its inquiry as limited to the fairness of the *allocation* in the *present* time frame, and not the circumstances existing in 1979-80 or other previous time periods:

> The salient issue here is not whether the agreement was reasonable when made, or whether it met the System objectives at the time it was made. Rather, the principal inquiry is whether the allocation is appropriate based on the evidentiary record that was subsequently developed.

Opinion 234-A, 32 FERC ¶ 61,425, at 61,957 (Sept. 26, 1985) (emphasis added).

28. Paragraph 28 is admitted, except that the quote is incomplete and in its context does not bear upon the issue here. NOPSI omitted the final portion of the quote, which read ". . . and may properly *bear* a portion of the *costs* of the unit." 32 FERC at 61,958 (emphasis added). NOPSI's obligation to remain responsible for a portion of the *cost* is not at issue. Rather the issue here is how it might moderate the risks inhering in that responsibility —by spreading such risks (and potential benefits) through off-system sales.

29. Paragraph 29 is incomplete and misleading. NOPSI had virtually no coal-fired power and had taken no action to obtain

interests in coal fired units, as others had. (R. Order at 80-83; 172-77; NOPSI Exh. 36; CNO Exh. 31 at 15; CNO Exh. 38 at 40; CNO Exh. 30(c) at 101-103; Tr. 499-503, 699-704, 814-15). The lack of content in the phrase "scheduled to own" is particularly misleading. No firm commitment was ever made by NOPSI for the "Wilton" plants; the plants were not proposed to be available for at least a decade; construction was repeatedly put off; the financing was completely undercut by the vast Grand Gulf obligation; and there was no evidence that construction had ever commenced. Rate Order at 83.

30. Paragraph 30 is admitted, but it is incomplete and misleading. The "*System's*" "*goal*" of moving toward coal and nuclear power does not obviate NOPSI's need to make sure that NOPSI has a proper mix of economical fuel sources on the Middle South System, where a company's costs were based largely on the decisions *it* made with respect to sources of generation. (See the section of the Rate Order at 68-71 entitled, "Impact of Generation Decisions in Relative Company Costs" and record citations therein.) NOPSI, for example, took no steps on its own to acquire coal-fired power as others did. (See Paragraph 29 above for citations.)

31. Paragraph 31, adapted from the Supreme Court's *MP&L* decision, is irrelevant and misleading in context here. The Council's Order does not find that the "system" should not have *constructed*, or completed construction, of the Grand Gulf plant; indeed, such issues were recognized by the Council as beyond the scope of its jurisdiction. The issue was what NOPSI should have done *assuming* that Grand Gulf 1 construction would be completed. These are discrete issues. To make this clear by analogy: An investor in a commercial building under construction who, like NOPSI here, has a commitment to lease space in it, may well decide it is economic to complete the building (as opposed to letting it stand as a half-completed shell), but also decide that it should reduce its commitment to take space by sell-offs (or subleases) to others. The two decisions are obviously subject to different considerations. Here, the Council found that NOPSI should not have retained all its Grand Gulf power.

The FERC's so-called "implicit" acceptance of uncontroverted testimony in a matter *not* actually put in issue there, and relating to the different issue of plant construction, not to diversification and individual company action, has no bearing here.

32. Paragraph 32 is admitted. The impact of the Three Mile Island incident, and NOPSI's failure to react to it, is described in the Rate Order at pages 87-88, 126-32, 145-156.

33. This is an apparent reference to Mr. Hurstell's rebuttal testimony (NOPSI App. 6), but he did *not* state that Grand Gulf was 70% complete by the end of March 1979, but rather that it was so "by the end of 1979." Further, it is not clear by what measure NOPSI asserts the plant construction to have been 70% complete in March 1979. However, the construction of Grand Gulf is not at issue. *See* Paragraph 31.

34. The quoted excerpts of Paragraph 34 are extremely misleading by omission. Mr. Komanoff's testimony (among other witnesses) was that the "regression analysis" *was* a traditional and standard analytical method and was in widespread use in the *public utility industry*, but, curiously, had not been used by industry specifically in relation to nuclear plant cost forecasting. This was, as established by other testimony as well, for the self-serving reason that its use reflected poorly on the industry's own invariably inaccurate cost projections for nuclear plant construction. The full excerpt from the transcript, with the testimony in bold letters representing the material *omitted* by NOPSI, is as follows:

MR. KOMANOFF:

I will. It's true that the conclusions in the book did differ radically from those of the parties that we've characterized. The method used in the book [the regression analysis] is *the most conservative, traditional and commonplace method* used

for analyzing empirical data. It is *used by all of these parties* that you and I have both discussed here. *It's used throughout the Federal Government.* It's used throughout the *electric utility industry* to do load forecasting. It's used by the *technical and policy communities* par excellence. What these people had not done, was to apply this standard tool to measuring the current level of costs and the rates of past and current increases in the costs of nuclear plants. And I believe that it would have been logical, professional and appropriate for them to have done so at that time. (emphasis added).

Q. What you're saying, then sir, is the methodology wasn't being used at all in the industry.

MR. WRUBLE:

That's exactly—I object to the form of the question, exactly contradictory to the testimony.

THE COURT:

I would like to hear the response to that question. Mr. Komanoff, could you respond to it? Explain your response.

MR. KOMANOFF:

Yes. The methodology did not have widespread use in the area of nuclear plant costs in 1979. **Now, *there certainly was use of it.* For example, the *Department of Energy* commissioned and published *several studies* that were performed at the Rand Corporation in Santa Monica that used precisely that method to measure and project costs for nuclear power plants. (emphasis added).**

BY MR. SCHULTZ:

Q. So what you're saying you have is a methodology that you believe is conventional, but does not have widespread use in the public utility industry?

A. For purposes of analyzing and predicting the costs of nuclear plants. *There is a very good reason for that,* and

the reason is as stated in the book. It's because the conclusions that one reaches from that method did differ radically from the prevailing view within the electric power industry, and *those conclusions were very threatening* to the prevailing view within the electric power industry concerning the accuracy of then current cost estimates for building nuclear power plants. (emphasis added.)

* * *

Q. All right. You have what you consider to be a conventional methodology, number one.

A. Yes.

Q. You consider it not to be—You consider it to be in widespread use for some other purpose, but not in widespread use in the public utility industry in 1979?

A. No. In widespread use in that industry for demand forecasting, for analyzing the variability of the demands for electricity by rate payers and customers as a function of weather conditions, income, geographical locations, multi-family versus detached homes, all electric versus nonelectric, the age of the office building, or the age of the home, et cetera. Wherever you've got lots of observations, lots of data, and many different causal factors that interact, and you need to know which causal factors matter and which ones don't matter so much, so that you can project future demand for electricity. That's what you do. And I'm saying that a very parallel situation existed as far as nuclear plant costs were concerned, and it would have been prudent to apply that tool and would have been—and was imprudent to not apply that tool in this other area.

Q. You're not just saying it would have been prudent to apply the tool, you're going a step further and saying it was imprudent not to apply the tool.

A. I am saying that, yes, sir.

Q. Notwithstanding the fact it was not in widespread use in estimating capital costs of nuclear power plants.

A. That's correct.

THE COURT:

Let's clarify that, please. I think, for my purposes and for the record, Mr. Komanoff, were you the first to suggest the use of that methodology for the capital costs therein?

THE WITNESS:

No. *The first work on this was published in December 1974.* And a second work was published—That first work was published at the *Harvard Business School and M.I.T.*, where they had a joint study group. (emphasis added.)

THE COURT:

What was your contribution, then, in terms of the literature?

THE WITNESS:

My contra—Let me just get the second, and I'm the third. *The second was by the Rand Corporation in 1978.* And it was that work that I saw in draft form in late 1977 that got me on to this avenue, and I even talk about it in the acknowledgements of the book. My contribution was to do an updated, complete analysis of nuclear and coal plant capital costs. (emphasis added.)

THE COURT:

So you were the third person involved in this arena?

THE WITNESS:

Yes, sir. But the first to apply a current, at least as of the 70s or late 70s, a current comprehensive comparison of nuclear and coal and then to put that to different regulatory factors. *It turned out to be much more damaging to nuclear costs than to coal power costs.*

THE COURT:

All right, sir. *I understand the context.* I'm sorry, Mr. Schultz. (emphasis added.)

Tr. 1646-1653.

Mr. Komanoff clearly established that the regression analysis was in widespread use, with the notable, curious and convenient exception of nuclear plant costs. NOPSI's *own witness,* Mr. McWhinney, testified that management should be judged by the information available to it, not what others in the industry were doing:

> Q. Is industry acceptance, in your view, Mr. McWhinney, a measure of—a useful measure of management prudence or imprudence?
>
> A. The answer is no. Because, as I've testified, my evaluation of the prudence of a decision is based on either the information management had or could have had, and this information was available, and could have been used, if it were not.
>
> Q. Could have been used, regardless of whether or not it was in widespread use?
>
> A. That's correct.

Tr. 1838-39, *reprinted in* Rate Order at 140.

Further, Mr. McWhinney confirmed Mr. Komanoff's view that regression analysis was the *standard* technique for determining trends:

> Q. The method itself is not radically different. It's an acceptable method.
>
> A. That's correct. It is not different. It is an accepted statistical method.
>
> Q. As a matter of fact, would it be fair to say that *the method is the standard technique for distilling trends from empirical data.*
>
> A. *That's correct.*

Tr. 1774 (emphasis added), *reprinted in* Rate Order at 138.

35. Paragraph 35 is, again, incomplete and misleading. See the full quote in Paragraph 34 above.

36. Paragraph 36 is denied. Mr. Komanoff's own work was "published" prior to 1981. As described in the Rate Order at page 135:

> Mr. Komanoff, a witness here, published in 1976 a book applying statistical analysis to nuclear and coal plant on-line performance (Tr. 1654). Thereafter, he used the same analytical methods to assess nuclear plant capital costs and made his conclusions known in testimony before a state regulatory commission in October 1978 (Tr. 1507). He disseminated his findings in a speech in September 1978, and they were in turn reported in *Nucleonics Weekly* (Tr. 1507), a publication which was read or known by "most people in the industry." (Tr. 1842-43). Drafts of material which became Mr. Komanoff's 1981 book, *Power Plant Cost Escalation* ("*PPCE*"), were circulated in 1978. (Tr. 1508). In addition, Mr. Komanoff testified before the Subcommittee on Energy and the Environment of the House Interior Committee in July 1979 as to the results of his statistical analysis of nuclear and coal plant costs and the implications of Three Mile Island. (Tr. 1663-4.)

37. The quotation set out in Paragraph 37 is accurate but misleading by omission. The "conclusions" of the book were radically different, but the *methodology* was traditional and standard, raising the question why the industry and others were using methods that were consistently and greatly understating nuclear plant costs. The answer was provided in part by Mr. McWhinney in the testimony quoted at pp. 139-141 of the Rate Order.

As described in the Rate Order, the method was applied to nuclear cost trends by some of the most prestigious and significant academic, research and government institutions:

> Beginning in the mid-1970's, a number of statistical studies were made public that undercut the conclusions and validity of the engineering estimation method. These studies showed that nuclear plant costs were increasing at a rate that was far in excess of both inflation and conventional cost estimates. The first was published in December 1974 by Professor I.C. Bupp of the *Harvard Business School* in conjunction with the researchers at the *Massachusetts Institute of Technology*. (Tr. 1651-2; NOPSI Exh. 38. at 46.) There followed two studies by William Mooz, published by the *Department of Energy* and the *Rand Corporation* respectively, in 1978 and 1979. (Tr. 1652; NOPSI Exh. 14 at 46.) These studies were widely distributed and discussed in the academic community, in federal agencies, at the *Electric Power Research Institute*, and other institutions. (*Id.*)

Rate Order at 134-35 (emphasis added).

38. The quoted excerpt in Paragraph 38 is accurate, but is out of context. The context is as described in response to Paragraphs 34 and 37 above.

39. Paragraph 39 is admitted, except that the phrase "as of 1979" should be changed to refer to the period after March 1979, when Three Mile Island occurred. The impact of the incident was demonstrated in the record and summarized in the Rate Order:

> The incident focused the nation's attention on nuclear safety issues and resulted in calls for the reorganization of the Nuclear Regulatory Commission and for new actions to ensure nuclear safety. The Three Mile Island incident had an immediate and profound effect on nuclear plant regulation and "came to dominate thoughts in nuclear regulation for the balance of that year and during the time since." (Tr. 1277.)
>
> The report of the President's Commission was released in October 1979, and contained serious criticism of the NRC. (Tr. 1294.) More broadly, the Three Mile Island incident precipitated a wide-ranging review of the whole structure of nuclear regulation beginning in 1979, and it had major cost implications for nuclear plants, including the Grand Gulf project (Tr. 1342-43.)

Rate Order at 87. Moreover, Mr. Komanoff's testimony emphasized the need for management to consider a *range* of possible cost outcomes. See Paragraph 41 *infra*.

40. The quotation in Paragraph 40 is, again, incomplete and thus misleading. The full quotation was as follows:

> Q. In 1979, how should one have estimated the effect of the TMI accident on future plants such as Grand Gulf?
>
> A. I would have added 25 percent to the estimate I obtained *on the basis of previous* (1971-1978) *nuclear cost experience*. Thus, whereas before the accident I would have projected a direct Grand Gulf capital cost of $889/kW, in 1979 dollars (without AFUDC), after the accident I would have added 25 percent for an estimate of $1111/kW.
>
> Q. Why would an addition of 25 percent have been appropriate?
>
> A. The 25 percent increase is my reconstruction of a judgment figure I would have considered prudent at the time. TMI was unprecedented and a watershed event. Neither I, nor anyone else, had a formula for estimating its effect on reactor costs. But the lack of a hard-and-fast method for estimating the impact wouldn't have obviated the need for an estimate. The accident was destined to have a major impact. My experience with quantifying changes in nuclear costs and changes in regulatory and safety criteria during the 1970s would have led me to select 25 percent as a reasonable, probably *conservative*, figure.

CNO Exh. 38 at 68 (emphasis added). The full excerpt shows that the 25% figure was based on previous actual experience, and that it was viewed as a *conservative* estimate (discussed further *infra* Paragraph 41).

41. The quoted excerpt in Paragraph 41 is grossly misleading. On cross-examination, NOPSI's attorneys repeatedly tried, without success, to get Mr. Komanoff to concede that it would have been reasonable for management to apply a 10% upward adjustment on the regression analysis for the impact of Three Mile Island. Mr. Komanoff's testimony was clear, and stated that prudent management should have considered a *range* of adjustments, with 10-15% being the *lowest* possible end of the range, with 25%

being *conservative*, and the upward end of the range being "open-ended" given the "watershed" nature of the event. The following is the full context, with NOPSI's omissions in bold print:

> **Q. And you explained to me that if an estimator in 1979 had applied a *range of assumptions*, that lower percentages from 25 percent and 20 percent would be reasonable.**
>
> **A. Um, *I didn't say that*, I don't think. I said it was possible, but, as you recall, I had a *range* of—of add—a *range of increments* or a range of percentage increments that I think would have been justified from Three Mile Island.**
>
> *** * ***
>
> **I won't read as much as I asked you to read in the previous passage, but on Page 48, on Line 16, you asked me [in deposition], "Can you tell me what you would have considered to be the lowest reasonable figure that someone might have been able to use in 1979 to estimate the impact of Three Mile Island on capital costs, the lowest reasonable percentage." So this, *I didn't answer in terms of a reasonable percentage*, because I've testified in my prefiled [testimony] that I thought 25 percent would have been reasonable, and on this same page, at the top of the page, I said on lines two and three that I thought that "25 percent resulting from Three Mile Island seems, if anything, on the modest side." And then on line seven, I remark that "In 1979, I was stating that the impact on the potential costs were absolutely open-ended." And so when I said 10 to 15 percent, that was in response to your specific request for the lowest reasonable impact estimate.**
>
> **Q. Well, let's get it back into context. You did tell me in the deposition that you didn't consider the percentages that you had applied to necessarily be the lowest reasonable figures someone might have used in 1979.**
>
> **A. That's right.**
>
> **Q. And you went on to tell me that in an analysis that would have included a range of percentages, that for original capital charges, it would not have been unrea-**

sonable under those circumstances for a 1979 estimator to use a figure, or a percentage of *perhaps 10 to 15 percent.*

A. *No.*

Q. And then working up from there.

A. ***I don't think I can agree with that.*** **Maybe the problem I have is with the qualifier under those circumstances. I mean do you mean—**

Q. Where the estimator is working on a range of estimates.

A. I think what I meant, then, and mean now—

Q. Let me read your deposition testimony. The question was, "What is the lowest reasonable percentage that might be used, and if you could tell me what that was." And in your answer on Line 23 on Page 48 was "Yes." The question is confirming that you understand it. And your answer is "I'm not sure that I would put it that way, I think, or I wouldn't have put it that way without having a range of figures that would have said at one end. It could have been virtually anything at the high end." I said, "I will accept that." And then you continue with your answer, "Probably then, as long as I can stipulate that, probably 10 or 15 percent at the low end."

A. Yes.

Q. And we're talking about original capital charges there, aren't we?

A. Yes, sir.

Q. Then we went on to discuss capital additions and station O and M. And you told me that subject to the same method of analysis, you would have used the same—you would have considered it reasonable to use the same percentages, at the low end 10 percent, the 15 percent for analyzing the impact of Three Mile Island. Isn't that correct?

A. Ah—

Q. I think the reference there might be page 52.

A. ***Mr. Schultz, I think there is an important distinction,*** **and let me go back to Page 48, line 17, but the question starts on 16, where you ask me what I would consider to have been the lowest reasonable figure that someone might have been able to use.** ***And I just don't want you imputing to me that I would have considered that a reasonable estimate that I would have put forward at the time.***

Q. *I think you have explained that, sir.* I'm just asking you to confirm, for the purpose of what we're doing here today, that under a *range of analyses* that might have taken place in 1979, you would have considered that range to have been appropriate, starting at 10 percent, and then working on up to some higher figures beyond that. Isn't that correct? (emphasis added.)

A. To some *much higher figures*, yes, sir.

Q. All right.

THE COURT:

I think the record is clear. The deposition is in the record. I think the witness has testified to the point that was just made. Do we need any more on this point?

MR. SHULTZ:

No, I'm ready to move from here.

Tr. at 1539-45.

Mr. Komanoff's testimony made clear that the 25% estimate was conservative, based on previous nuclear cost trends. He testified that in the six to seven years prior to TMI, nuclear costs had already doubled due to increased safety and regulatory requirements. CNO Exh. 38 at 69.

42. Paragraph 42 is denied. The evidence showed that there were *57* potential purchasers identified by Middle South in its 1982 offering of Grand Gulf power, after the costs of Grand Gulf had increased dramatically. Rate Order at 105; NOPSI Exh. 36, MLH-21, 57. Unless viewed as a sham offering, this is direct evidence that there was a significant number of "potential purchasers."

NOPSI's assertion that no particular purchaser was identified reflects the fact that it was NOPSI's (1) failure to act and (2) testimony before the Council in 1980, designed to lull the Council into inaction, that resulted in there being no evidence of specific offers and responses thereto during the 1979-1980 period. Moreover, under conventional application of burden of proof rules here, it was NOPSI's responsibility to show that no such sales were available to it (*see* Rate Order at 38-41), and for reasons stated above the absence of additional evidence is clearly NOPSI's responsibility.

43. Paragraph 43 is denied. The Rate Order identified several "missed" opportunities where coal-fired power was available to NOPSI, but NOPSI refused to pursue it. NOPSI instead concentrated on portraying Grand Gulf power as the cheapest available source of power.

> Because NOPSI was determined to portray Grand Gulf as a cheap source of energy, it never sought alternative sources (principally coal-fired) as part of its program to displace oil and gas. Moreover, as NOPSI confirmed in response to the Council's data request number PC-4, *it never undertook any comparison of Grand Gulf costs to coal-fired alternatives.* (CNO Exh. 38 at 40.)

NOPSI assumed a passive role and did not consider purchasing any share of White Bluff because it 'was not made available to us' (Tr. 502)—although forty percent of the plant was sold to non-system companies. (NOPSI Exh. 40 at 6.) NOPSI's president claimed to have discussed an opportunity to buy participation in the ISES coal plant but did not pursue it because of NOPSI's plans for Wilton. (Tr. 503.) However, NOPSI had no concrete commitment for the Wilton coal plant at any time. Moreover, the Wilton project was, in any event, almost a decade off; NOPSI's anticipated share of the project's capacity was relatively small (80 MW); and the likelihood of NOPSI's participation in Wilton was itself rendered problematical by the looming costs of Grand Gulf.

It is highly probable that coal-fired power was available to NOPSI during relevant period. For example, MP&L apparently began consideration of purchasing participation in ISES by no later than January 1980. The matter was actively discussed and negotiated in that year, and it was completed in 1981. MP&L's purchase involved 400 MW. Total sales to others by AP&L from the 4 units comprising White Bluff and ISES amounted to 1984 MW. (CNO Exh. 38 at 36.) There is reason to assume that NOPSI would have been able to participate also, had it actively pursued the matter, instead of passively assuming that no coal-fired power was available.

In addition, coal-fired power was available from the Southern Company for at least a five year period—certainly long enough to give NOPSI an opportunity to let the "dynamic time period" settle and to seek other alternatives. While Mr. Hurstell claimed that he ignored this opportunity because Southern Company's coal-fired power was not available for the life-of-the-plant, this was certainly not a prerequisite to its being valuable. (Tr. 699-704; 911-913). In related testimony before the LPSC, Mr. Hurstell stated that short-term purchases represented useful opportunities:

> Q. Mr. Hurstell, you just finished telling me 20 minutes ago that one year purchase of White Bluff or two year purchase of White Bluff or three year-year [*sic*] purchase of White Bluff is just as good as a permanent purchase of a unit, didn't you?
>
> A. Yes, sir.

Rate Order at 172-73 (emphasis added).

44. Paragraph 44 is denied for the same reason as were similar statements contained in Paragraph 26. The hypothetical situation posed by NOPSI's attorneys to Mr. Komanoff was unreal and useless. The hypothetical assumed that the prospective purchaser of Grand Gulf power was substantially *identical* to NOPSI in its needs, and its analyses, and information and projections of the costs of nuclear and coal power sources. Obviously, in such a situation—with two substantially identical parties—there likely would be no transaction. NOPSI never tried to prove that all

potential purchasers (MSU had identified 57 in 1982) were identically situated with NOPSI.

The quoted excerpt is, again, incomplete and misleading. The portions omitted by NOPSI are displayed in bold print.

MR. WRUBLE:

You're asking him to hypothesize if the AP&L coal was available to this buyer; you are asking him to further calculate that the buyer has analyzed the cost of Grand Gulf respectively in precisely the same way NOPSI has or should have at the time and has performed the same calculation with respect to the costs of coal.

In other words, ***you have got a particular buyer and seller both with the same opportunities, premises, understandings and projections, and you're asking him to assume that circumstance.*** **(emphasis added.)**

MR. SHULTZ:

Q. I'm not trying to tell you what, you know, use your standard for what's a prudent buyer, but once you have a prudent buyer with equal access to the coal power from AP&L as NOPSI, when NOPSI would want to sell its interest in Grand Gulf to that buyer, doesn't it have to at least match the price of the coal from AP&L?

MR. KOMANOFF:

A. Well, I think ***the assumptions in the question have created an identity between NOPSI and the buyer*** **in that their cost of the coal option is identical and their perception of the cost of Grand Gulf is identical, and under that circumstance, NOPSI would have to indeed discount Grand Gulf to a point such that both NOPSI and its buyer would each individually be indifferent on a cost per kilowatt-hour projection indifferent between having Grand Gulf and having the coal-fired capacity and, in fact, I've estimated that discount and believe that it's on the order of about a 50 percent discount and in the sunk cost to achieve the—(emphasis added.)**

Q. Price parity, price equality?

A. Price parity, yes, thank you.

Q. Okay. So in that situation, with that kind of buyer, NOPSI doesn't—this maneuver by NOPSI doesn't save any money, does it?

A. That's right, it doesn't make NOPSI's projected generating costs any less than it would be without the deal.

Now, there are these other criteria that I consider important, the so-called intangibles, such as risk, and managerial intention, by your assumption probably would extend to cover those as well so that the management of this other utility feels the same way about the so-called intangible factors as NOPSI does.

Q. Well, I don't know about that.

MR. WRUBLE:

Well, I would observe that ***under the conditions you specify, that no transaction took place.*** **(emphasis added.)**

Obviously, in the market place here, if all people have the same situation, in the stock market and have the same information, they deal in precisely the same way.

MR. KOMANOFF:

And the same criteria, yes, the same criteria, ***what makes a market is differences in people and differences in situations.*** **(emphasis added.)**

Q. When you include the intangibles, and you're taking [*sic*] about the intangibles near the end of your testimony where you said if price is equal between coal and nuclear from Grand Gulf, coal should be preferred?

A. Yes.

Q. So taking the situation that we've been talking about and factoring in those intangibles, wouldn't that mean that the discount on the nuclear power from Grand Gulf would actually have to be equal to a price below the cost of power from AP&L, coal power from AP&L?

A. If the buyer, if the potential buyer, who had access to both NOPSI's Grand Gulf and NOPSI's coal optioned that view of the intangibles, which I feel a prudented [sic] buyer should have had, then the answer is yes.

Q. Can you express the value of the discount attributable to those intangibles under the circumstances of the sale that we've been discussing?

A. I think I did that implicitly earlier when I said that for NOPSI, if the projected nuclear to coal or Grand Gulf to coal lifetime cost ratio went down to around .9, then NOPSI might just as well have held onto a considerable part of Grand Gulf and there is about a two to one ratio.

I guess in these prospective calculations in '79, the capital charges were or the sunk capital charges are about half of the total life-cycle costs for Grand Gulf. So to go down to .9—

Q. We can work out the conversion later.

What you're saying is that the discount for the intangibles is worth about 10 percent of lifetime costs?

A. Yes.

NOPSI Exh. 50 at 81-85.

45. Paragraph 45 is inaccurately stated, because it should properly have recited the assumptions that underlie the unreal hypothetical noted above, and it merely extends that hypothetical to monetary results.

46. Paragraph 46 is unclear. There were a number of structures suggested, but no one undertook fully to particularize the purchase and sale transactions, and it was unnecessary to do so. As to one point, the Rate Order states:

> Finally, the fact that NOPSI's share of Grand Gulf I was not a fixed amount (until NOPSI committed to a large share in 1980) does not excuse NOPSI's inaction. In the circumstances prevailing in 1979, NOPSI could be *sure* that it would be required to take (or would have access to) a sizeable share of Grand Gulf I, and certainly could have styled contracts giving it a right to sell a significant portion to others. Moreover, contractual clauses dealing with unexpected events would have been possible, if indeed they were necessary. Uncertainty is inherent in business decisions and did not entitle NOPSI to do nothing in the circumstances described.

Rate Order at 171.

47. Paragraph 47 is admitted. It should be noted, however, that Resolution R-85-423 invited NOPSI to apply for interim rate relief pending a prudence investigation, but NOPSI declined it, and instead filed its first action here, *NOPSI I.*

48. Paragraph 48 is irrelevant here, as NOPSI never raised a claim of procedural infirmity while the hearings were in progress. The Council decided that the Hearing Examiner should preside over the proceedings and develop a record, but not make findings thereon. The objective was to gather the evidence, since it was clearly impractical to try to schedule the whole Council, as well as lawyers and witnesses, for weeks of evidence-taking. This order was issued on February 6, 1986, and NOPSI made no objection to it at that time, or at any time during the course of the prudence hearings. Instead, NOPSI "saved" it until after the conclusion of the proceedings, and raised an objection to it in a letter dated July 31, 1987. The Hearing Examiner had no notice during the hearing that he was to make any findings, and the idea of asking him to take on the requirement retroactively was manifestly impractical, if not absurd. This objection was rejected by the Council by letter of August 6, 1987 as contrary to legal requirements. Letter From Dorothy Mae Taylor to James M. Cain (Aug. 6, 1987). Moreover, NOPSI made no "procedural" claims in its complaint filed here.

There is no requirement in Louisiana that a hearing examiner make findings. The Louisiana Administrative Procedure Act does

not require it, but rather reflects that the examiner may not do so; and the Louisiana Public Service Commission's rules do not require it. (*See* Memorandum of Law.)

Similarly, the Federal Administrative Procedure Act does not require such procedure. It expressly provides that agencies may require the hearing officer to certify the entire record to it without making an initial decision. 5 U.S.C. § 557(b) (1982). Moreover, even where the officer makes an initial decision, the Act provides that "on appeal from or review of the initial decision, the agency has all the powers which it would have in making the initial decision," 5 U.S.C. § 557(b) (1982), and thus even if the officer found facts, the agency would not be in any way bound thereby. *See* K.C. Davis, Administrative Law Treatise § 17:14 (2d Ed. 1980).

49. Paragraph 49 is accurate but irrelevant, and is nowhere implicated in the Rate Order or NOPSI's complaint.

50. Paragraph 50 is accurate but irrelevant. AP&L's attempt to avoid any allocation of Grand Gulf was rejected by the FERC on the grounds that it sought to avoid "system" responsibility for an appropriate share of the plant. Here, the Council did not dispute the allocation by FERC to NOPSI (as recognized by the Supreme Court in *NOPSI III*), but rather found that NOPSI could have kept its obligation to the System, while selling off a portion of its commitment to reduce its retail-level risk, as it said it could do.

> It should be noted that a sale off-system by NOPSI of part of its Grand Gulf power entitlement would not have undercut any financial obligation—established by the system or by the FERC—that NOPSI might have had with respect to Grand Gulf I. NOPSI, for example, could have remained financially responsible for its portion of Grand Gulf. A part thereof would have been sold to and paid for by one or more customers secured by NOPSI. The payments received would

> have been used by NOPSI to discharge its obligation to pay wholesale costs for its portion of Grand Gulf.

Rate Order at 168.

51. Paragraph 51 is admitted.

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Dated: October 16, 1989

CERTIFICATE OF SERVICE

I hereby certify that I have this 16 day of October 1989 served copies of the foregoing Defendants' Response to Statement of Uncontested Material Facts on all counsel of record, by hand or first class mail, postage prepaid.

UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF LOUISIANA

NEW ORLEANS DIVISION

NEW ORLEANS PUBLIC SERVICE, INC.	CIVIL ACTION
VERSUS	NO. 88-559
THE COUNCIL OF THE CITY OF NEW ORLEANS, ET AL	SECTION "D"

Transcript of proceedings had in the above-entitled matter, held in the Courtroom, 500 Camp Street, New Orleans, Louisiana, on Wednesday, October 25, 1989, before the Honorable A. J. McNamara, District Judge presiding.

* * *

FILED
U.S. DISTRICT COURT
EASTERN DISTRICT OF LA.
Nov. 3 2:40 PM '89
Loretta G. Whyte
Clerk

REPORTED BY: THOMAS H. CONRAD, CSR, CP
OFFICIAL COURT REPORTER

* * *

[Pp. 20–21.]

THE COURT: Let me ask you something else, suppose that instead of hearing this case on the summary judgment that right now, today, this was the trial on the merits—

MR. SCHULTZ [for NOPSI]: Yes, sir.

THE COURT: What would I have before me that I don't have here, would I just have the record which I already have, which I have received from the City Council's inquiry, or the prudence inquiry, or would I have some other testimony to consider?

MR. SCHULTZ: Well, if for some reason this Court denied its motion for summary judgment, I can't say right now whether or not NOPSI would have some evidence that they would want to introduce at a trial on the merits, or not. I just haven't, I don't know. What I'm saying is that this Court can decide this motion for summary judgment based upon what the Court has in front of it, now, that's what I am prepared to say. To say that this Court gives us reasons for not granting the motion that I just can't anticipate as I stand here to say that there might not be some evidence that NOPSI could and would introduce.

THE COURT: I guess that's why I was asking earlier is my decision based on a review of the record that was made up at the prudency hearing, or are we going outside that?

MR. SCHULTZ: In order to decide this motion for summary judgment, the record that was made at the prudency hearing is sufficient for this Court to determine that there was, if not facial preemption at the very least, pretextural [*sic*] preemption. Whether or not we get to a trial on the merits or not, I just couldn't answer that, right now.

* * *

[Pp. 29–30.]

THE COURT: So, under your standard, then, it wouldn't make any difference today whether I would, according to you and I realize the motion isn't noticed this way, but your position would be that I would do nothing different and my opinion would be nothing different if we were handling this case as a summary judgment today, or as trying the case on the merits submitted on documents, including that administrative record?

MR. VINCE [for the Council of the City of New Orleans]: The difference is that their summary judgment format doesn't suggest that. They have got the redacted portions, but not the full record.

What I am suggesting is you must take the full record.

THE COURT: I understand that, that I will take the full record, I am not bound in the summary judgment by just that which counsel has brought to my attention in their briefs. But, my question to you is suppose I was hearing this case on the merits today, you are suggesting to me I've got everything before me, that I would have the entire record.

MR. VINCE: Correct, you would look at the administrative record.

THE COURT: With deference.

MR. VINCE: With deference and substantial evidence. And if you somehow adopted NOPSI's standard which is de novo, then I would want to file a brief because I think there would need to be new evidence in that situation.

Supreme Court, U.S.
FILED
JUL 3 1991
OFFICE OF THE CLERK

(10)

No. 90-1156

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*,
Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

PETITIONER'S BRIEF

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QUESTION PRESENTED

Whether states or municipalities have jurisdiction to review the "prudence" of decisions that a utility made during construction of a wholesale electrical generating plant and to bar recovery of, and thereby "trap," over $135 million of wholesale costs that the Federal Energy Regulatory Commission ("FERC") found to be "just and reasonable" and ordered the utility to incur?

RULE 29.1 STATEMENT

Petitioner New Orleans Public Service Inc. ("NOPSI") is a wholly-owned subsidiary of Entergy Corporation ("Entergy"). Entergy has no parent company, and neither Entergy nor NOPSI has any subsidiaries that are not wholly-owned by Entergy either directly or through other wholly-owned subsidiaries.

PARTIES BELOW

NOPSI was the plaintiff in the District Court. The defendants were The Council of the City of New Orleans, Joseph I. Giarrusso, Lambert C. Boissiere, Jr., Michael Early, James Singleton, Dorothy Mae Taylor, Johnny Jackson, and Peggy Wilson. In addition, the Alliance for Affordable Energy, Inc., Citizens for Safe Energy, Inc., and Gary L. Groesch were granted leave to intervene on the side of defendants after the District Court's and the Fifth Circuit's initial decisions were reversed and remanded by this Court in *NOPSI* v. *Council of New Orleans,* 491 U.S. 350 (1989).

TABLE OF CONTENTS

	Page
Question Presented	i
Ruie 29.1 Statement	ii
Parties Below	ii
Table of Authorities	v
Opinions Below	1
Jurisdiction	1
Constitutional And Statutory Provisions	2
Statement of the Case	2
A. The FERC Orders And Their Background	4
1. NOPSI And The Middle South System	4
2. Grand Gulf And The MSU Fuel Diversification Program Of The 1970s	6
3. The FERC Proceedings	7
B. The Council's Retail Rate Proceedings And Its Grand Gulf Disallowance Order	13
C. This Case And The Subsequent State Proceedings	16
Summary of Argument	20
Argument	22
I. The Fifth Circuit's Holding Is Contrary To The Terms Of The Federal Power Act And To FERC's Consistent Interpretation Of Them	23
II. The Fifth Circuit's Holding Is Contrary To *MP&L, Nantahala,* And Their Numerous Precursors	28

	Page
A. *Nantahala* And *MP&L* Establish FERC's Exclusive Jurisdiction Over Claims Of "Imprudence" After Plant Construction Has Begun	30
B. As In *MP&L* And *Nantahala*, The Prudence Disallowance Does Not Involve "Cost Savings In Other Areas"	34
C. *MP&L* And *Nantahala* Were Not Overruled By This Court's Subsequent Abstention Opinion In This Case	35
III. The Council's Order Has Relitigated The Very Matters That Were Before FERC And Has Collaterally Attacked FERC's Findings	37
A. The Council's Findings And Assumptions Are Inconsistent With FERC's Orders In Three Fundamental Respects	37
1. The Council Has Collaterally Attacked The Reasonableness Of NOPSI's 17% Allocation	38
2. The Council Has Collaterally Attacked The Joint Planning Requirements	40
3. The Council Has Collaterally Attacked FERC's Cost Allocation Principles	41
B. Such Collateral Attacks Are Facially Preempted By FERC's Orders	43
Conclusion	45

TABLE OF AUTHORITIES

Cases	Page(s)
Alliance for Affordable Energy, Inc. v. *Council of New Orleans*, 578 So. 2d 949 (La. Ct. App. 4th Cir. 1991)	19, 20
Appeal of Sinclair Machine Products, Inc., 126 N.H. 822, 498 A.2d 696 (1985)	22, 43
Arkansas Electric Cooperative Corp. v. *Arkansas Public Service Commission*, 461 U.S. 375 (1983)	23, 24
Arkansas Louisiana Gas Co. v. *Hall*, 453 U.S. 571 (1981)	29, 42
Burford v. *Sun Oil Co.*, 319 U.S. 315 (1943)	16
Chicago & N.W. Transp. Co. v. *Kalo Brick & Tile Co.*, 450 U.S. 311 (1981)	29, 37, 39
City of New Orleans v. *FERC*, 875 F.2d 903 (D.C. Cir. 1989), *cert. denied*, 110 S. Ct. 1805 (1990)	12, 13
Eastern Edison Co. v. *Department of Public Utilities*, 446 N.E.2d 684 (Mass. 1984)	26
FPC v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944)	25
FPC v. *Southern California Edison Co.*, 376 U.S. 205 (1964)	23, 24
Kentucky West Virginia Gas Co. v. *Pennsylvania Public Utility Commission*, 837 F.2d 600 (3d Cir. 1988)	36
Maryland v. *Louisiana*, 451 U.S. 725 (1981)	29
Massachusetts v. *United States*, 729 F.2d 886 (1st Cir. 1984)	24
Mississippi ex rel. Pittman v. *Mississippi Public Service Commission*, 506 So. 2d 978 (Miss. 1987)	32
Mississippi Industries v. *FERC*, 808 F.2d 1525, *modified in part*, 822 F.2d 1104 (D.C. Cir.), *cert. denied*, 484 U.S. 985 (1987)	12
Mississippi Power & Light Co. v. *Mississippi ex rel. Moore*, 487 U.S. 354 (1988)	*passim*

	Page(s)
Montana-Dakota Utilities Co. v. *Northwestern Public Service Co.*, 341 U.S. 246 (1951)	29
Nantahala Power & Light Co. v. *Thornburg*, 476 U.S. 953 (1986)	*passim*
NOPSI v. *Council of New Orleans*, 782 F.2d 1236 (5th Cir. Feb. 14, 1986), *modified on reconsideration*, 798 F.2d 858 (5th Cir. Sept. 2, 1986)	13
NOPSI v. *Council of New Orleans*, 833 F.2d 583 (5th Cir. 1987)	13
NOPSI v. *Council of New Orleans*, 491 U.S. 350 (1989)	*passim*
New England Power Co. v. *New Hampshire*, 455 U.S. 331 (1982)	24
Northern Natural Gas Co. v. *State Corporation Commission of Kansas*, 372 U.S. 84 (1963)	29
Northern States Power Co. v. *Hagen*, 314 N.W.2d 32 (N.D. 1981)	27
Northern States Power Co. v. *Minnesota Public Utilities Commission*, 344 N.W.2d 374 (Minn. 1984)	27
Pennsylvania Water & Power Co. v. *FPC*, 343 U.S. 414 (1952)	25
Prudential Insurance Co. v. *Benjamin*, 328 U.S. 408 (1946)	23
Public Utilities Commission of Ohio v. *United Fuel Gas Co.*, 317 U.S. 456 (1943)	36
Public Utilities Commission v. *Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927)	23
Schneidewind v. *ANR Pipeline Co.*, 485 U.S. 293 (1988)	29
Younger v. *Harris*, 401 U.S. 37 (1971)	16, 35, 36

	Page(s)
Administrative Decisions	
AEP Generating Co., 36 FERC (CCH) ¶ 61,226 (1986)	27
AEP Generating Co. and Kentucky Power Co., 38 FERC (CCH) ¶ 61,243 (1988)	27
Arizona Public Service Co., 25 FERC (CCH) ¶ 63,025 (1983), *aff'd*, 27 FERC (CCH) ¶ 61,185 (1984)	27
Arizona Public Service Co., 21 FERC (CCH) ¶ 63,007 (1982), *aff'd*, 23 FERC (CCH) ¶ 61,419 (1983)	27
Arizona Public Service Co., 27 FERC (CCH) ¶ 61,185 (1984)	27
Connecticut Light & Power Co., 43 FERC (CCH) ¶ 63,029 (1988), *aff'd*, 48 FERC (CCH) ¶ 61,139 (1989)	27
Kansas Gas & Electric Co., 39 FERC (CCH) ¶ 63,013 (1987), *aff'd*, 49 FERC (CCH) ¶ 61,295 (1989)	26
Middle South Energy, Inc., 26 FERC (CCH) ¶ 63,044 (1984)	*passim*
Middle South Energy, Inc., FERC Opinion No. 234, 31 FERC (CCH) ¶ 61,305 (1985)	*passim*
Middle South Energy, Inc., 32 FERC (CCH) ¶ 61,207 (1985)	8
Middle South Energy, Inc., FERC Opinion No. 234-A, 32 FERC (CCH) ¶ 61,425 (1985)	*passim*
Middle South Services, Inc., 30 FERC (CCH) ¶ 63,030 (1985)	3, 6, 12
Minnesota Power & Light Co., 11 FERC (CCH) ¶ 61,312 (1980)	26

	Page(s)
New England Power Co., 31 FERC (CCH) ¶ 61,047 (1985), *aff'd sub nom., Violet* v. *FERC*, 800 F.2d 280 (1st Cir. 1986)	26, 33
New England Power Co., 32 FERC (CCH) ¶ 61,112 (1985)	26
Northern States Power Co., 17 FERC (CCH) ¶ 61,196 (1981), *aff'd sub nom., South Dakota Public Utilities Commission* v. *FERC*, 690 F.2d 674 (8th Cir. 1982)	27
System Energy Resources, Inc., FERC Opinion No. 292, 41 FERC (CCH) ¶ 61,238 (1987)	3, 11, 12
System Energy Resources, Inc., FERC Opinion No. 292-A, 42 FERC (CCH) ¶ 61,091 (1988)	3, 12
Union Electric Co., 35 FERC (CCH) ¶ 63,076 (1986)	26
Union Electric Co., 40 FERC (CCH) ¶ 61,046 (1987), *rev'd on other grounds*, 890 F.2d 1193 (D.C. Cir. 1989)	26

Statutes

Federal Power Act, 16 U.S.C. §§ 791-828	
Section 201	24, 28
Section 205	8, 24, 25
Section 206	8, 24, 25, 28
Section 306	25
15 U.S.C. § 79	4, 23
28 U.S.C. § 1254(1)	1
28 U.S.C. § 1738	17
La. Civ. Code art. 3556(31)	17
La. Code Civ. Proc. art. 1842	17

Miscellaneous

	Page(s)
18 C.F.R. §§ 4-141	36
Brief Of Council Of City Of New Orleans As Amicus Curiae, *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, No. 86-1970 (filed January 22, 1988)	31
Brief on Exceptions of the City of New Orleans, Louisiana (March 5, 1984), *Middle South Energy, Inc.*, FERC Docket No. ER82-616-000	8
Brief on Exceptions of the City of New Orleans, Louisiana (March 6, 1985), *Middle South Services, Inc.*, FERC Docket No. ER82-483-000	8, 10

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-1156

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*,
Respondents.

PETITIONER'S BRIEF

OPINIONS BELOW

The Fifth Circuit's opinion of August 29, 1990 is reported at 911 F.2d 993 and reprinted at pages 2A-24A of the Petition for Certiorari ("Cert. App."). On February 8, 1991 (after the Petition was filed), the Fifth Circuit amended this opinion by deleting the phrase ", the amount the Council had argued NOPSI should bear in the FERC proceedings" from p. 6089 of the Slip Opinion (Cert. App. 8A), and the opinion, as thus amended, is reprinted at pages 11-33 of the Joint Appendix ("J.A."). The opinion of the District Court (Cert. App. 26A-32A) is unreported.

JURISDICTION

The opinion and judgment of the Court of Appeals were entered on August 29, 1990. Cert. App. 2A; J.A. 11. On October 17, 1990, the Court of Appeals denied rehearing. Cert. App. 34A. This Court's jurisdiction is invoked under 28 U.S.C. 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS

The pertinent provisions of the Federal Constitution and the Federal Power Act, 16 U.S.C. 791a-828c, are reprinted at Cert. App. 35A-46A.

STATEMENT OF THE CASE

Introduction

This case presents the same question that was decided in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986) (*"Nantahala"*), and in *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore* (*"MP&L"*), 487 U.S. 354 (1988): whether a state or municipality may use its retail ratemaking authority to nullify a FERC decision that allocates wholesale electrical generating costs among affiliated utilities that serve different states. Indeed, this case involves the same FERC orders that were at issue in *MP&L* and a retail ratemaking order that does precisely what was held *per se* unlawful in *MP&L*. This Order has "prevented NOPSI from recovering" (Cert. App. 2A; J.A. 11)—and thereby has "trapped"—costs of the Grand Gulf nuclear power plant that FERC found to be "just and reasonable" and ordered NOPSI to incur. *See MP&L*, 487 U.S. at 372.

Here, as in *MP&L*, the retail ratemaking proceeding amounts to a collateral attack on FERC determinations. The City of New Orleans participated in the massive FERC proceeding that established "just and reasonable" wholesale rates for Grand Gulf power and that allocated its costs among NOPSI and the other affiliated utilities that comprise an integrated multistate utility system. New Orleans there urged FERC to prescribe rates in which NOPSI and its retail ratepayers would be allocated 9% of Grand Gulf and would receive correspondingly greater benefits of the system's lower-cost coal power. In 1985, FERC rejected these arguments and ordered NOPSI to purchase 17% of the output of Grand Gulf at FERC-approved wholesale rates.

However, The Council of the City of New Orleans has barred NOPSI from recovering over $135 million of these FERC-mandated costs on the ground that a "prudent" utility would have avoided them. In particular, the Council found that if NOPSI had been prudent, it would, in 1979-1980, have sold off all but 9% of the then-contingent interest in Grand Gulf, obtained equivalent amounts of lower-cost coal power instead, and thereby reduced its future wholesale costs by the *precise amounts* that the City unsuccessfully asked FERC to order in 1985, five years later.

As FERC and the United States have stated, the Council's Order rests on grounds that are within FERC's exclusive jurisdiction, that could have been raised before FERC, and that, in many instances, were in fact raised by New Orleans or other parties and rejected by FERC.[1]

Because the pertinent FERC orders[2] and the Council's Order have each been before the Court before, many of the pertinent facts can be set forth briefly.

---

[1]Brief for the United States and the Federal Energy Regulatory Commission as Amici Curiae Supporting Petitioner ("Feb. 1991 FERC Amicus Br."), pp. 11-16 (February, 1991).

[2]Six different FERC orders are germane. The allocations and wholesale rate determinations were initially addressed in two decisions of administrative law judges (*Middle South Energy, Inc.*, 26 FERC (CCH) ¶ 63,044 (1984) and *Middle South Services, Inc.*, 30 FERC (CCH) ¶ 63,030 (1985)), and two decisions by FERC. *Middle South Energy, Inc.*, FERC Opinion No. 234, 31 FERC (CCH) ¶ 61,305 (1985), and *Middle South Energy, Inc.*, FERC Opinion No. 234-A, 32 FERC (CCH) ¶ 61,425 (1985). Following a decision by the D.C. Circuit, FERC issued two orders reaffirming and further explaining the basis for its previous allocation. *System Energy Resources, Inc.*, FERC Opinion No. 292, 41 FERC (CCH) ¶ 61,238 (1987), and *System Energy Resources, Inc.*, FERC Opinion No. 292-A, 42 FERC (CCH) ¶ 61,091 (1988). Each FERC decision will be cited as "____ FERC at ____."

For the Court's convenience, NOPSI has lodged with the Court ten separately-bound volumes that each contain copies of the foregoing FERC opinions.

A. The FERC Orders And Their Background.

1. NOPSI And The Middle South System.

Like MP&L, petitioner NOPSI is one of four operating utilities that is owned by Entergy Corporation (formerly known as Middle South Utilities, Inc.) ("MSU"), which is a public utility holding company.[3] These four MSU operating companies each provide retail and wholesale electric service in separate service areas in four different states, and their retail rates are regulated by five different state and local ratemaking bodies. NOPSI provides retail electric service in New Orleans, and its retail rates are regulated by The Council of the City of New Orleans ("Council" or "Council of New Orleans").

The MSU operating companies are required to be planned and "operated as a single interconnected and coordinated [interstate] system"—the MSU system—because this integration has been found to produce cost savings that are unobtainable by the individual companies. 15 U.S.C. §§ 79b(a)(29) & 79k(b); *see* J.A. 108. Thus, although NOPSI and the other MSU operating companies each separately own some generating capacity, "the four [MSU] companies operate as an integrated power pool" in which the companies make "wholesale sale[s] of electricity to each other." *MP&L*, 487 U.S. at 357. Each MSU company "transmit[s] the electricity [it] produce[s] to a central dispatch center and . . . draws back the power it needs to meet customer demand." Cert. App. 3A-4A; J.A. 12.

The arrangements for the generation, sale, and exchange of electricity among the MSU companies have been governed by a series of power pool agreements ("System Agreements") that are

[3]Louisiana Power & Light Company ("LP&L") and Arkansas Power & Light Company ("AP&L") are the other two MSU operating companies. In addition, MSU owns a separate generating subsidiary, System Energy Resources, Inc. (formerly Middle South Energy, Inc.) ("MSE"). MSE has title to the MSU system's 90% interest in the Grand Gulf Unit 1 nuclear power plant generating station ("Grand Gulf").

filed with FERC and that are binding FERC rate schedules. *MP&L*, 487 U.S. at 357.[4] These agreements provide "the basis for planning and operating the companies' generating units on a single-system basis" and determine how the MSU operating companies share the system's costs of electric capacity[5] and electric energy.[6] *MP&L*, 487 U.S. at 357.

In particular, the system agreement requires that generation planning be performed by a system-wide Operating Committee, which is comprised of one representative from each MSU operating company and one representative from MSU. This Committee establishes a "generation addition plan" for the system as a whole. J.A. 41. The Operating Committee decides when generating facilities will be added, what types to add, and which MSU company will construct, or obtain, the new facilities. *See* 31 FERC at 61,647-50. Because long-term contracts are an alternative way in which a utility acquires generating capacity, the Operating Committee similarly decides whether an individual operating company may purchase capacity from outside sources or make off-system sales of capacity to other unaffiliated utilities.[7]

In short, although an individual MSU operating company has some "autonomy" under the system agreements (*e.g.*, in managing construction of those plants it is assigned to build), it is the system Operating Committee that determines the kinds and

[4]During the planning and construction of Grand Gulf, the applicable FERC rate schedule was the 1973 System Agreement. J.A. 34-54.

[5]"Capacity" is the amount of electricity available from a generating unit or facility at any one time. A system must have capacity that exceeds "peak" demand, plus a reasonable reserve. Capacity is measured in kilowatts. Capacity costs are the fixed costs of either owning a generation unit or purchasing generating capacity under contract.

[6]"Energy" is the amount of electricity delivered over time; it is measured in kilowatt-hours. Energy costs are the variable costs (*e.g.*, labor and fuel) of each unit of electricity produced by a plant.

[7]*See* 1973 System Agreement, § 4.01 (requiring Operating Committee approval of off-system sales) (J.A. 40-42) & § 4.02 (requiring Operating Committee approval of off-system purchases) (J.A. 42).

quantities of generating capacity that the MSU companies have. *See* 31 FERC at 61,645-51; 30 FERC at 65,141-43. This centralized planning has meant that different MSU companies often have different amounts of capacity relative to their needs and different "mixes" of high-cost and low-cost power. But the System Agreements have prevented significant disparities in the generating costs of the MSU operating companies by requiring "equalization" payments from operating companies that have less than their share of system capacity ("short companies") to companies that have more than their share ("long companies"). *See MP&L*, 487 U.S. at 357, 360. NOPSI has been a "short" company during all periods pertinent to this case.

2. Grand Gulf And The MSU Fuel Diversification Program Of The 1970s.

In the late 1960s, Middle South made a system decision to meet projected increases in demand by ending its exclusive dependence on gas and oil-fired generating facilities and by adding nuclear and coal-fired generation. As part of this effort,[8] Middle South Energy ("MSE") was formed in 1974 to construct and operate Grand Gulf. *MP&L*, 487 U.S. at 358.

The information available in 1974 showed that Grand Gulf would be needed to meet projected increases in system demand. However, it was apparent by the late 1970s that system-wide demand "would be lower than had been forecast" and that the plant would be costlier to build than had been originally anticipated due to severe inflation and to the regulatory delays that would result from the 1979 Three Mile Island accident. *MP&L*,

[8]The system Operating Committee had earlier assigned the construction of nuclear plants to AP&L (ANO 1 and 2) and to LP&L (Waterford 3 and 4), and it was originally planned that MP&L and NOPSI would each finance and construct one of the Grand Gulf nuclear units. *See* 26 FERC at 65,102. However it proved infeasible for NOPSI and MP&L to finance and build Grand Gulf, so MSE was formed for that purpose. *MP&L*, 487 U.S. at 358 & n.3.

487 U.S. at 359. MSU then deferred or cancelled other planned nuclear and coal-generating facilities. But Grand Gulf 1 was 70% finished in 1980, and MSU decided to complete it because it believed that "the relatively low cost of nuclear fuel would make the overall cost of Grand Gulf power per kilowatt hour lower than that of alternative energy sources." *MP&L*, 487 U.S. at 359.

However, inflation and the "additional construction requirements" that the Nuclear Regulatory Commission imposed led to far greater increases in the costs of completing Grand Gulf 1 than had been anticipated—as they did in the case of an LP&L plant (Waterford 3) and "virtually every nuclear power facility [then] being constructed in the United States." *MP&L*, 487 U.S. at 367 n.9; *see id.* at 358 n.3. Grand Gulf 1 ended up costing $2,933 per kilowatt of capacity when it began operations—or approximately six times the original forecast. *MP&L*, 487 U.S. at 359 & n.5. FERC found that these cost escalations between 1980 and 1985 were "unforeseen" and "unexpectedly dramatic" (31 FERC at 61,654-55) and that the decision to complete Grand Gulf had been "prudent."[9]

3. The FERC Proceedings.

In 1982, the Middle South system filed two new agreements with FERC as rate schedules. The first of these agreements—the Unit Power Sales Agreement ("UPSA")—established the wholesale rates for Grand Gulf power and allocated its energy and capacity among the MSU operating companies. The second—the 1982 System Agreement—otherwise modified the method by which overall generation capacity costs are equalized among the MSU operating companies.

[9]Administrative Law Judge Liebman expressly so found:

> "[C]ontinuing construction of Grand Gulf Unit No. 1 was prudent because Middle South's executives believed Grand Gulf would enable the Middle South system to diversify its base load fuel mix and, it was projected, at the same time, [to] produce power for a total cost (capacity and energy) which would be less than existing alternatives on the system."

26 FERC at 65, 112-13. FERC "approved" this finding. *MP&L*, 487 U.S. at 363; *see* 31 FERC at 61,666 (affirming ALJ Liebman's findings to the extent not modified).

Pursuant to Sections 205 and 206 of the Federal Power Act, FERC instituted two separate dockets (before ALJs Head and Liebman) to investigate these rate schedules and to assure that they are "just, reasonable, and nondiscriminatory." MSE submitted voluminous testimony that (1) reviewed the MSU system's decisionmaking over the period from the late 1960s to 1982, (2) showed that it had appeared that the total generating costs of Grand Gulf power would be lower than all available alternatives at each pertinent time during this period, and (3) otherwise defended the proposed rates and allocations. *See MP&L,* 487 U.S. at 360-62.

New Orleans and representatives of each other affected jurisdiction (Mississippi, Arkansas, and Louisiana) intervened in this proceeding because they recognized that FERC's decision would have "substantial rate impacts" on each of the MSU operating companies and their retail customers. *Middle South Energy, Inc.,* 32 FERC (CCH) ¶ 61,207 at 61,478 (1985); *see MP&L,* 487 U.S. at 375. Indeed, New Orleans repeatedly stated that the FERC rates and allocations would have to be included in retail rates and that FERC had to protect the interests of retail ratepayers in New Orleans (and elsewhere) in avoiding "excessive" or "discriminatory" wholesale rates.[10]

New Orleans and other affected jurisdictions did not challenge the "uncontroverted testimony" that building and completing Grand Gulf had been prudent. *MP&L,* 487 U.S. at 363. However, each jurisdiction advanced arguments in which its operating utility would receive little or no higher-cost Grand Gulf power and correspondingly greater benefits of the MSU system's lower-cost capacity. *See MP&L,* 487 U.S. at 360-61. New Orleans argued that NOPSI should be allocated no more than 9% of Grand Gulf

[10]*E.g.,* Brief on Exceptions of the City of New Orleans, Louisiana, pp. 18-36 (March 5, 1984), *Middle South Energy, Inc.,* FERC Docket No. ER82-616-000; Brief on Exceptions of the City of New Orleans, Louisiana, pp. 24-25, 30-50 (March 6, 1985), *Middle South Services, Inc.,* FERC Docket No. ER82-483-000.

and should receive proportionately more low-cost coal power. New Orleans made over 1,000 pages of submissions in support of its claims.

FERC's Opinions 234 And 234-A. After three years of proceedings, FERC issued its final decision in FERC Opinions 234 and 234-A. FERC decided two major issues.

First, FERC established the "just and reasonable" wholesale rates that NOPSI and each MSU operating company "will pay to MSE" for Grand Gulf power. 31 FERC at 61,655-57. FERC ruled on the objections that New Orleans and other intervenors had raised to the inclusion of certain expenses in MSE's rates and to the rate of return that had been proposed. *See, e.g.,* 26 FERC at 65,124-49; 31 FERC at 61,657-66. Because no one challenged the testimony and findings that Grand Gulf was reasonably and "prudently" planned, constructed, and completed to meet the needs of the MSU System "as a whole" (*see* p. 7 n.9, *supra*), FERC established wholesale rates that would allow MSE to "recoup 100% of the costs of Grand Gulf in the wholesale rates it charged to the four operating companies." *MP&L,* 487 U.S. at 375.

Second, FERC allocated "the costs of Grand Gulf capacity and energy" among the "four operating companies and their customers." 31 FERC at 61,633. Due to the unforeseen developments occurring since the MSU companies had agreed to the proposed allocations in January of 1980, FERC found that UPSA and the 1982 System Agreement would not, as filed, result in wholesale rates that were "just, reasonable, and nondiscriminatory" and that the MSU operating companies must be required to "share the cost of the system's investment in nuclear energy in proportion to their relative demand for energy generated by the system as a whole." *MP&L,* 487 U.S. at 364. To achieve this allocation,

FERC substantially approved the 1982 System Agreement, but changed the allocation percentages in UPSA, as follows:

	UPSA as filed	Allocation under Opinion No. 234
AP&L	0%	36%
LP&L	38.57%	14%
MP&L	31.63%	33%
NOPSI	29.80%	17%

In short, although 10% of Grand Gulf had previously been sold off-system in Mississippi,[11] FERC proportionately allocated 100% of the system's remaining nuclear investment among the four MSU operating companies.

FERC's Rejection Of New Orleans's Arguments. FERC thus explicitly rejected New Orleans's arguments that NOPSI should receive a Grand Gulf allocation of 9% and correspondingly greater benefits from lower-cost coal power. In particular, New Orleans had urged FERC to adopt ALJ Head's proposal under which the costs of Grand Gulf *alone* would be allocated among the MSU companies based on their relative shares of system demand. Because NOPSI's approximate share of the system's peak demand is 9%, this method would have given NOPSI a 9% Grand Gulf allocation and, the Council claimed, would have allowed NOPSI to obtain more lower-cost coal capacity.[12]

[11]MSE had previously sold an undivided 10% interest in the plant to some unaffiliated Mississippi utilities. *See* 31 FERC at 61,668 n.3. FERC also made it explicit that, in that event of future such off-system sales of Grand Gulf, FERC would determine the ratemaking consequences of those transactions for the MSU operating companies and their customers. In that event, FERC stated that no "gains or losses" could be reflected in MSE's rates unless future filings were first made with FERC and FERC approved. 26 FERC at 65,148-49, *aff'd.* 31 FERC at 61,666.

[12]*See, e.g.*, Brief on Exceptions of the City of New Orleans, Louisiana, p. 48 (March 6, 1985), *Middle South Services, Inc.*, FERC Docket No. ER82-483-000.

FERC flatly rejected New Orleans's proposal. *See, e.g.*, 31 FERC at 61,651-54. FERC found that the disparity in production costs had resulted from the "unforeseen" increases in the capacity costs of all the system's post-1980 nuclear facilities (not just Grand Gulf), that *each* of the facilities had been built to serve the system as a whole, and that the establishment of "just, reasonable, and nondiscriminatory" rates required that each MSU operating company bear its proportionate shares of the system's *entire* nuclear investment.[13] Because NOPSI had no nuclear plant (*see* p. 6 n.8, *supra*), a 17% Grand Gulf investment was required to give NOPSI its proportionate 9% share of the system's nuclear investment. *See* Cert. App. 5A-6A n.3; J.A. 14-15 n.3.[14]

New Orleans also made a related argument that would not have affected NOPSI's Grand Gulf allocation, but that proceeded from the City's allegation that NOPSI had too little coal capacity and higher non-nuclear generation costs than the other MSU companies. In particular, New Orleans claimed that if FERC was going to modify the Unit Power Sales Agreement to equalize nuclear capacity costs among the MSU companies (as FERC, of course, did), then FERC should also take the additional step of

[13]For this reason, FERC rejected the arguments of Arkansas and Mississippi parties that Grand Gulf allocations should be based on (1) the needs of individual MSU companies for additional capacity (*see MP&L*, 487 U.S. at 364; 32 FERC at 61,958); (2) representations that operating company officials had made to state and local officials (*see MP&L*, 487 U.S. at 376-77 n.14); or (3) the MSU companies' agreed-upon allocations (*see* 31 FERC at 61,643-44).

[14]Indeed, rather than give NOPSI a share of Grand Gulf that was disproportionate to its size—as the Council contended—FERC found that a 17% Grand Gulf allocation actually gave NOPSI (due to rounding) *lower* nuclear capacity costs per megawatt of its average peak demand than any of the other MSU operating companies (41 FERC at 61,616):

	AP&L	LP&L	MP&L	NOPSI
Nuclear Costs per Megawatt of Average Demand ($ Thousands)	816	822	806	751

modifying the 1982 System Agreement to equalize all other production costs as well. FERC rejected this proposal on the ground that it was unnecessary to achieve just, reasonable, and nondiscriminatory rates.[15] Contrary to New Orleans's allegations, FERC found that "the overall production costs of all generation facilities other than nuclear were roughly comparable" (41 FERC at 61,618) and that equalizing nuclear investment costs alone would "ensure approximate equalization of costs responsibility on a per unit of demand basis." *Id.* at 61,617; *see* 32 FERC at 61,959-61.

Subsequent FERC And Appellate Proceedings. The New Orleans, Arkansas, and Mississippi parties each appealed FERC's decision in Opinions 234 and 234-A, and each reiterated the arguments that FERC had rejected. In 1987, the United States Court of Appeals for the District of Columbia Circuit unanimously affirmed FERC's jurisdictional holdings. *Mississippi Industries* v. *FERC*, 808 F.2d 1525, 1539-53 (D.C. Cir.), *cert. denied*, 484 U.S. 985 (1987). However, the Court of Appeals held that FERC had not adequately explained its reasons for ordering equalization of the system's nuclear investment costs, and remanded the case to FERC for further proceedings. *Id.*, 822 F.2d 1104, 1105 (D.C. Cir. 1987); *see id.*, 808 F.2d at 1568-69 (Bork, J., dissenting in part). *See MP&L*, 487 U.S. at 364.

On remand, New Orleans reiterated the same claims that it made in 1985. FERC again rejected New Orleans's claims and reaffirmed the allocation that it had ordered. 41 FERC at 61,613-17, 61,620-23; 42 FERC at 61,624-26. New Orleans again appealed these FERC opinions to the D.C. Circuit. The Court of Appeals rejected New Orleans's claims on the merits, and this Court denied certiorari last term. *City of New Orleans* v. *FERC*,

[15]FERC agreed with New Orleans that it had jurisdiction to order full production cost equalization—irrespective of its impact on state utility commissions' jurisdiction over non-nuclear costs. 31 FERC at 61,644-61, 645; *see* 30 FERC at 65,148-51, 65,165.

875 F.2d 903 (D.C. Cir. 1989), *cert. denied*, 110 S. Ct. 1805 (1990). Accordingly, the FERC orders are final and are not subject to further review.

B. The Council's Retail Rate Proceedings And Its Grand Gulf Disallowance Order.

On May 17, 1985, NOPSI filed for the retail rate increase required to recover the Grand Gulf expenses that FERC had ordered NOPSI to begin incurring on July 1, 1985. The Council did not grant this request, but on October 10, 1985, the Council instituted a prudence investigation "for the purpose of determining what portion, if any, of NOPSI's Grand Gulf 1 expenses should be assumed by shareholders, rather than being passed through to its retail ratepayers." Resolution No. R-85-636; *see* J.A. 55. These actions led NOPSI to file two sequential suits in federal court (*NOPSI I*[16] and *NOPSI II*[17]), which were each ultimately dismissed on procedural grounds.

In March of 1986, following an initial decision in NOPSI's favor in *NOPSI I*, the Council agreed to enter a retail rate order as a partial "settlement" of the pending dispute. Resolution No. R-86-112 (March 20, 1986). This retail rate order finally resolved all non-Grand Gulf rate issues. It further allowed NOPSI to put into effect retail rate schedules in which NOPSI would ultimately recover all but $51.2 million of its Grand Gulf expenses on a phased-in basis.[18] In particular, under the retail schedules,

[16]*NOPSI* v. *Council of New Orleans*, 782 F.2d 1236 (5th Cir. Feb. 14, 1986) (reversing District Court's dismissal order and remanding for decision of federal preemption claims), *modified on reconsideration*, 798 F.2d 858 (5th Cir. Sept. 2, 1986) (affirming District Court's dismissal on abstention grounds).

[17]*NOPSI* v. *Council of New Orleans*, 833 F.2d 583 (5th Cir. 1987) (affirming dismissal on ripeness grounds).

[18]In order to obtain interim rate relief and avoid insolvency, NOPSI agreed to have its shareholders absorb $51.2 million of these Grand Gulf expenses.

NOPSI would defer recovery of some of its Grand Gulf expenses in early years, but ultimately would recover the deferred expenses, plus financing and carrying charges. However, this "settlement" provided that NOPSI's right to recover Grand Gulf expenses was subject to the outcome of the pending prudence investigation. NOPSI, in turn, reserved its rights to challenge the investigation and any order entered in it.

The Council's Order. On February 4, 1988, the Council released a 224-page report in the prudence investigation ("Order"). *See* J.A. 58-245. In this Court's words, this Order "examined the prudence of NOPSI's failure, after the risks of nuclear power became apparent [in 1980], to diversify its supply portfolio." *NOPSI* v. *Council of New Orleans,* 491 U.S. 350, 367 (1989). The Council found NOPSI's conduct to be "negligent" *(id.)* and ordered NOPSI to exclude $135 million from the booked deferred Grand Gulf expenses th[illegible]PSI otherwise would recover from retail ratepayers. That dis[illegible]nce would produce a total loss to NOPSI of approximately $3[illegible]illion (including carrying costs).

This disallowance order rests on the Council's belief that NOPSI has too much higher-cost nuclear capacity relative to its size (*see* J.A. 71-72), and too few benefits from lower-cost coal capacity. J.A. 129-32; 203-08. But the basis for the Order is the Council's finding that if NOPSI management had been "prudent" in 1979 and 1980, NOPSI could have and would have taken steps to avoid these higher costs by entering into certain wholesale purchases and sales of bulk power supplies.

In particular, after rejecting NOPSI's claims that the FERC rate schedules and decisions precluded these transactions and savings,[19] the Council found that a prudent NOPSI would have

[19]The Council rejected what it termed NOPSI's "System Defense": that the System Agreement required NOPSI to rely on the system's
(Footnote continued on next page)

done the following in 1979 and 1980. It would have independently reviewed the MSU system generation and fuel diversification plan. J.A. 70-71, 161-67. It would have concluded that the MSU system was using the wrong method to estimate the costs of Grand Gulf (J.A. 132-34, 171-91) and that Grand Gulf power likely would be 20% more expensive than coal. J.A. 192-97. Finally, the Council found that a prudent NOPSI would, for this reason, have sold off that portion of its then yet-to-be-determined allocation of Grand Gulf "that exceeded a 9% share,"[20] bought equivalent amounts of lower-cost coal-fired capacity, and thereby reduced its future wholesale costs attributable to Grand Gulf by 31%. J.A. 72, 198, 203-08.

In this regard, the Council stated that it assumed that there was a utility who could have "prudently" bought an essentially indeterminate share of Grand Gulf in 1980, despite the Council's finding that it then was imprudent for NOPSI to have such a share. *Compare* J.A. 202, *with* J.A. 155-61 & 197-203. Neither then nor at any time since has the Council identified any utility that would have been willing to buy Grand Gulf high-cost power and sell low-cost coal-fired power.

Finally, the Council's order did not disallow the full 31% of NOPSI's Grand Gulf costs that the Council found to have been

(Footnote continuedfrom previous page)
generation planning and prohibited NOPSI from independently seeking to nullify the system's fuel diversification plan through unilateral off-system purchase and sales. *See* J.A. 120, 161-67 & 171-208. The Council construed the FERC rate schedules to give NOPSI "autonomy" to take these steps in order to discharge its "independent" responsibilities to local ratepayers. J.A. 111-20.

[20]The Council found that in 1979-80 NOPSI should have then sold "substantially all" of its Grand Gulf allocation, but that "based on the expert testimony in the record" NOPSI "might have retained a portion of Grand Gulf I relative to its comparative size within the MSU system —that is, about 9% of the system's Grand Gulf I obligation." J.A. 71-72.

imprudently incurred. The Council found that a disallowance of this magnitude would bankrupt NOPSI and prevent it from making its Grand Gulf payments—contrary to the Council's "intention" (J.A. 72-73, 241-42). The Council "limited" the disallowance to $135 million, which represented the amount that the Council found that NOPSI could absorb without going bankrupt ($150 million), plus a $15 million cushion. J.A. 72-73. *But see* p. 20, *infra.*

C. This Case And The Subsequent State Proceedings.

On February 9, 1988, NOPSI filed this action in federal District Court to enjoin the Council's Order on the ground that it is preempted by FERC's orders under the Federal Power Act. The District Court abstained—in a decision affirmed by the Fifth Circuit—on the ground that the doctrines of *Burford* v. *Sun Oil Co.*, 319 U.S. 315 (1943), and *Younger* v. *Harris*, 401 U.S. 37 (1971), each required NOPSI to litigate its federal claims exclusively in pending parallel state court proceedings.

This Court reversed. First, it held that NOPSI had raised two federal claims that could be maintained on remand without violating *Burford*'s rule against federal court review of "essentially local" regulatory decisions. The District Court could determine that the Council's retail rate order is "facially preempted by FERC's allocative decree" because that required "no inquiry beyond the four corners of the Council's retail rate order." *NOPSI*, 491 U.S. at 363. The District Court could also find that "the rate order's nominal emphasis on NOPSI's failure in 1979-1980 to diversify its power supply by selling off a portion of its Grand Gulf allocation" was merely a "cover" or a "pretext" for a determination that the Grand Gulf allocation was "unwise." *Id.*

Second, this Court held that *Younger* v. *Harris* does not bar litigation of these two claims because the pending state judicial proceedings are not enforcement actions, but are "no more than a state-court challenge to completed legislative action." *NOPSI*, 491 U.S. at 372-73.

The District Court's Decision on Remand. On remand, NOPSI filed a motion for summary judgment that raised each of the two claims identified by this Court in *NOPSI III*.

First, NOPSI claimed that the Council's Order is "facially preempted" because it was apparent from the four corners of the Order that (1) it barred recovery of FERC-mandated costs contrary to *MP&L* and *Nantahala*, and (2) the Council has not only regulated the same "area" in which FERC exercised jurisdiction but also collaterally attacked FERC's actual and implicit findings. Second, NOPSI alternatively claimed that the Council's Order is a "cover" or "pretext" for a challenge to FERC's allocation because—as the District Court's earlier statements had graphically shown—the Council "assumed" and "pulled out of thin air" the facts that would enable the Council collaterally to attack the FERC allocation on the precise grounds FERC rejected. *See NOPSI*, 491 U.S. at 357 n.2 (quoting District Court).

On January 4, 1990, after the state trial court had issued a decision in the Council's favor on these claims in the pending state cases, the District Court, on its own motion, entered an order that rejected NOPSI's facial claims and that stayed further proceedings on the pretext claims pending completion of all appeals in the parallel state court proceedings.[21] Cert. App. 26A-32A. The District Court held that "[f]acially, the Council's Order

[21]The Council had responded to the state trial court decision by moving to dismiss this federal action on grounds of *res judicata* under 28 U.S.C. § 1738. NOPSI opposed this motion on the ground that the applicable provisions of the Louisiana Civil Code provide that a final judgment of a Louisiana court does not become *res judicata* ("the thing adjudged")—and cannot acquire preclusive effect under 28 U.S.C. § 1738—until "there can be no [further] appeal." La. Civ. Code art. 3556(31); *see* La Code Civ. Proc. art. 1842. Although the District Court did not deny the motion directly, it decided the merits of NOPSI's facial preemption claim. The Fifth Circuit subsequently rejected the Council's full faith and credit claim in reviewing the stay of NOPSI's separate pretext claim (Cert. App. 23A; J.A. 32).

is not preempted by federal law" because the Council did not "question the validity of FERC's allocative decree" or "attempt to regulate interstate utility rates." Cert. App. 26A-27A. The District Court then stayed further proceedings on NOPSI's pretextual preemption claim on the ground that this claim involves no substantial federal questions, but merely substantial evidence review under state law. Cert. App. 27A-32A.

The Fifth Circuit's Decision. The Fifth Circuit affirmed on both grounds. First, although it recognized that "[t]he Council's order prevented NOPSI from recovering, in its retail rates, wholesale costs FERC ordered it to incur as a result of its participation in [Grand Gulf 1]" (Cert. App. 2A; J.A. 11), the Fifth Circuit held that the Council's Order is not "facially preempted" under *MP&L* and *Nantahala*. Cert. App. 15A-18A; J.A. 24-27.

The Fifth Circuit stated that *MP&L* and *Nantahala* "reaffirmed the well-established principle that if FERC has jurisdiction over a subject, states cannot have jurisdiction over it." Cert. App. 16A; J.A. 24. However, the Fifth Circuit concluded that *MP&L* and *Nantahala* "established" only that "FERC had jurisdiction to determine whether [NOPSI and the other MSU] utilities acted prudently in deciding to participate in the Grand Gulf venture" initially (Cert. App. 16A; J.A. 24-25), and that *MP&L* and *Nantahala* had not decided a different "variation" of this question that this case presents: "whether FERC has jurisdiction to determine whether NOPSI acted prudently once the Grand Gulf project was underway." Cert. App. 16A; J.A. 25.

In deciding this question, the Fifth Circuit stated that "it is plain that FERC did not assert jurisdiction to determine NOPSI's prudence in not acting to minimize its losses" and that the Fifth Circuit had to "assume" that FERC lacks this jurisdiction. Cert. App. 16A-17A; J.A. 25-26. Otherwise, the court stated, FERC

could preempt the states from exercising what the Fifth Circuit regarded as their "traditional[ ]" regulatory authority and could achieve "the result Justice Brennan feared" in his dissenting opinion in *MP&L*: "that is, to 'divest states of authority to determine the prudence of costs incurred by retail utilities whenever those utilities belong to an interstate pool.' " Cert. App. 17A; J.A. 26.

The Fifth Circuit concluded that Congress had not expressed a "clear and manifest" purpose to confer this jurisdiction upon FERC. Cert. App. 17A; J.A. 26. Accordingly, the Fifth Circuit held that it is the states, and not FERC, that have exclusive jurisdiction to determine the "prudence" of a utility's "failure" to "minimize its losses" by "diversify[ing] its supply portfolio" during construction of a system plant. Cert. App. 15A-16A; J.A. 24-25. The Fifth Circuit believed that this view was supported by this Court's earlier *abstention* opinion in this case and was "analogous" to *Nantahala*'s statement that wholesale rate increases need not result in retail rate increases when the utility has achieved "cost" savings in "other areas." Cert. App. 17A-18A; J.A. 26.

Second, the Fifth Circuit also upheld the District Court's decision to stay the "pretextual" preemption claim on the ground that it does not present a "substantial federal question[ ]," but involves only sufficiency of the evidence review under state law. Cert. App. 20A-22A; J.A. 29-31.

The Subsequent State Court Proceedings. After the Fifth Circuit issued its decision, an intermediate appellate court in Louisiana (the Court of Appeal for the Fourth Circuit) entered a decision in the parallel state court proceeding.[22] It rejected

[22] *Alliance for Affordable Energy, Inc.* v. *Council of New Orleans*, 578 So. 2d 949 (La. Ct. App. 4th Cir. 1991); *see* Petitioner's Supplemental Filing Pursuant to Rule 15.7 (filed April 6, 1991).

NOPSI's "facial preemption" claims on the ground that the decision of the Fifth Circuit (and this Court's earlier abstention decision) are *res judicata* on this issue unless and until reversed by this Court. 578 So. 2d at 965-66. The court upheld the Council's findings of imprudence on the ground that NOPSI had not "carried its burden" of disproving the critical facts that the Council had assumed. 578 So. 2d at 958-64.

The Louisiana Court of Appeal further held that the Council had erred in mitigating the prudence disallowance to prevent NOPSI's bankruptcy, and the court ordered the disallowance of an additional $290.38 million of NOPSI's FERC-mandated expenses. 578 So. 2d at 974. Unless reversed by the Louisiana Supreme Court,[23] this decision would increase the prudence disallowance that is before this Court from $135 million (plus carrying charges) to $425.38 million (plus carrying charges). Such a disallowance would render NOPSI insolvent.

SUMMARY OF ARGUMENT

The Fifth Circuit's decision is contrary to the terms of the Federal Power Act and to this Court's explicit holdings in *MP&L, Nantahala,* and numerous prior preemption decisions. They each establish that FERC has exclusive jurisdiction to determine a utility's "prudence" while construction of a wholesale generating facility is "underway" (Cert. App. 16A; J.A. 25) and that states are thus preempted from doing what the Council concededly has done: preventing a utility from recovering in its retail

[23]NOPSI and the Council have sought discretionary review of this decision in the Louisiana Supreme Court. The applications are limited to (1) the state law issues raised by the Court's $135 million disallowance (which NOPSI raises), and (2) the issues raised by the intermediate appellate court's decision to increase the disallowance (which NOPSI and the Council raise). NOPSI has not sought Louisiana Supreme Court review of the threshold facial preemption claim because the Fifth Circuit's decision is *res judicata* in the state case. *See* Petition, pp. 10-11 & n.8.

rates—and thereby "trapping"—the Grand Gulf costs that FERC found "just and reasonable" and ordered the utility to incur.

The Federal Power Act establishes a uniform and orderly procedure in which a neutral federal forum—FERC—protects the legitimate interests of states and retail ratemaking bodies in assuring that wholesale power rates are "just, reasonable, and nondiscriminatory" and do not impose "excessive" or unwarranted costs on retail ratepayers. Contrary to the Fifth Circuit's holding, this grant of jurisdiction requires that FERC examine the reasonableness of decisions made by a utility after construction of a wholesale generating facility was "underway" and to exclude any imprudently incurred expenses from wholesale rates. Indeed, because it is these utility decisions that principally determine the utility's costs, FERC routinely exercises jurisdiction to decide the very types of prudence claims that the Council has asserted.

MP&L, Nantahala, and decades of this Court's prior preemption decisions recognize that FERC has exclusive jurisdiction to make all such prudence determinations. Indeed, it was the need to "enforce" FERC's "exclusive jurisdiction" over all elements of wholesale ratemaking that led this Court to develop the "filed rate doctrine" and to hold that states "setting retail rates must allow . . . costs incurred as a result of paying a FERC-determined wholesale price." *Nantahala,* 476 U.S. at 962-67.

MP&L applied this principle to the very Grand Gulf costs at issue. It held that states may not do what the Council has done: "enter an order 'trapping' the costs [an MSU operating company] is mandated to pay under the FERC order allocating Grand Gulf power" or even "undertake a 'prudence' review for the purpose of deciding whether to enter such an order." *MP&L,* 487 U.S. at 372. Indeed, contrary to the Fifth Circuit's holding, *MP&L* involved prudence challenges to conduct occurring during construction of Grand Gulf, and *MP&L* established that the Coun-

cil's prudence claims are matters that "FERC easily could have considered" in setting Grand Gulf rates and in allocating its power among the four MSU operating companies. *Id.* at 375. As Justice Scalia stated, *MP&L* established FERC's exclusive jurisdiction over any and all such prudence claims. *Id.* at 377-83 (Scalia, J., concurring).

Further, the Council's Order has not merely decided claims that could be presented to FERC. It has collaterally attacked FERC's determinations. Most fundamentally, the linchpin of the Council's Order is the Council's *rejection* of FERC's finding that MSU companies "prudently" believed in 1980 that Grand Gulf would "produce power for a total cost . . . which would be less than existing alternatives." *MP&L*, 487 U.S. at 363, *quoting* 26 FERC at 65,112-13. As the New Hampshire Supreme Court has stated, a holding that allows states to review the very matters decided by FERC—and bar FERC-mandated costs on such grounds—defeats the "federal objective of providing orderly and streamlined procedures for approval of wholesale transactions." *Appeal of Sinclair Machine Products, Inc.*, 126 N.H. 822, 830, 498 A.2d 696, 702 (1985).

ARGUMENT

The Fifth Circuit's "facial preemption" holding creates an exception to FERC's jurisdiction that would swallow the rule. It is also an exception that is contrary to common sense.

The Fifth Circuit has held that FERC's jurisdiction over bulk power supply arrangements is limited to the initial decisions to "participate" in the construction of wholesale generating facilities. Cert. App. 16A; J.A. 24-25. Accordingly, the Fifth Circuit has held that it is the states, not FERC, that have exclusive jurisdiction to determine the prudence of a participating utility's conduct once construction of the facility is "underway." Cert. App. 16A-18A; J.A. 25-27. Under this holding, each state served by an integrated multistate power system may do what this Court held to be preempted in *MP&L*, *Nantahala*, and numerous prior

decisions—relitigate the reasonableness of FERC-approved wholesale rates and allocations and "trap" FERC-mandated costs.

The Fifth Circuit's holding is erroneous. It is contrary to the plain terms of the Act and to FERC's consistent interpretation of them. *See* Part I, *infra*. It is contrary to *MP&L*, *Nantahala*, and numerous prior preemption decisions of this Court. *See* Part II, *infra*. Finally, because the Council has relitigated the very matters that were before FERC—and collaterally attacked its actual and implicit findings—it could not be clearer that its Order has nullified FERC's determinations for the only purpose for which they matter. *See* Part III, *infra*.

I. The Fifth Circuit's Holding Is Contrary To The Terms Of The Federal Power Act And To FERC's Consistent Interpretation Of Them.

Congress enacted the Federal Power Act because it recognized that the production and transmission of bulk supplies of electrical power are "particularly likely to affect more than one State," and that "uncontrolled [State] regulation" can "patently interfere with broader national interests."[24] State regulation would mean that the reasonableness of wholesale power rates and the underlying interstate cost allocations would be litigated and relitigated

[24] *Arkansas Elec. Coop. Corp.* v. *Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 377 (1983); *see FPC* v. *Southern California Edison Co.*, 376 U.S. 205 (1964); *Public Utilities Comm'n* v. *Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927). Although the Federal Power Act was enacted to fill the "gap" created by *Attleboro*'s holding that states could not regulate such transactions, Congress could have filled the "gap" by authorizing state regulation. *See Prudential Ins. Co.* v. *Benjamin*, 328 U.S. 408, 427-33 (1946). Instead, Congress codified *Attleboro*'s concerns that parochial state regulation would burden interstate commerce and gave FERC jurisdiction over all wholesale power transactions. Indeed, Congress contemporaneously found, in the Public Utility Holding Company Act of 1935, that wholesale power transactions in integrated multistate systems "are not susceptible of effective control by any State." 15 U.S.C. § 79a(a).

in multiple state forums and that inconsistent state determinations could impair interstate commerce vital to the nation.[25]

The Federal Power Act prevents this interference with commerce by centralizing all these determinations in a single neutral federal forum—FERC—and by establishing a uniform, orderly procedure in which all legitimate state interests can be raised and protected.[26] Under Section 205 of the Act, each utility must file with FERC a "rate schedule" that contains the utility's charges for wholesale sales of electricity, and all contracts and arrangements affecting these wholesale rates. FERC is required to assure that these rate schedules are "just and reasonable" and nondiscriminatory. Federal Power Act, §§ 205 & 206; Cert. App. 37A-43A.

Because these determinations directly affect retail rates, the Act gives states, municipalities, and retail ratemaking bodies explicit rights to participate in FERC proceedings, to file complaints with FERC, and otherwise to urge FERC to prevent the imposition of excessive or unwarranted costs on retail ratepayers.

[25]*Arkansas Elec. Coop. Corp.*, 461 U.S. at 377; *see Attleboro Steam & Elec.*, 273 U.S. at 90 (each state would then protect its "respective local interests"); *Massachusetts* v. *United States*, 729 F.2d 886, 888 (1st Cir. 1984) (Breyer, J.) (each state would then seek to "benefit[ ] its residents to the detriment of its neighbors"); *cf. New England Power Co.* v. *New Hampshire*, 455 U.S. 331 (1982).

[26]The Act gives FERC exclusive jurisdiction to regulate the "transmission" and the "sale of electric energy at wholesale in interstate commerce." Federal Power Act, § 201(b); Cert. App. 36A. Section 201(d) of the Act defines "[s]ale of electric energy at wholesale" to mean "sale of electric energy to any person for resale": that is, sales to or exchanges with a utility that will, in turn, resell the electricity to retail customers or to utilities serving such customers. *See* Cert. App. 37A.

As this Court has held, the Act thus draws a "bright line easily ascertained" to divide state and federal authority. *FPC* v. *Southern California Edison Co.*, 376 U.S. 205, 215-16 (1964). FERC is given "plenary jurisdiction" to regulate all aspects of wholesale transactions, regardless of the impact of state regulation. *See id.*

Federal Power Act, §§ 205, 206, 306; Cert. App. 37A-44A. FERC is authorized to "balanc[e] . . . the investor and the consumer interests" (*FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944)) and to assure that wholesale power supply arrangements do not result in "excessive prices" to any class of power consumers. *Pennsylvania Water & Power Co.* v. *FPC*, 343 U.S. 414, 418 (1952).

Contrary to the Fifth Circuit's holding, this grant of jurisdiction requires FERC to make determinations of the "prudence" of not just a utility's *initial* decision to participate in building a wholesale generating plant, but also of the capacity planning and other decisions made by power pools and the participating utilities while construction of the plant is "underway." The reality is that it is the decisions made during construction of a generating facility that principally determine utilities' costs.[27] FERC simply cannot assure that wholesale rates are "just, reasonable, and nondiscriminatory" unless it can assure that these decisions were made in good faith, were reasonable when they were made, and thus do not result in the imposition of excessive or unwarranted rates on power consumers.

The Fifth Circuit is also in error in stating that FERC has not "asserted" jurisdiction to decide these prudence claims. *See* Cert. App. 16A; J.A. 25. Even the Council's Order acknowledges this point, for the Council states that it applied "the same standard of

[27]Wholesale generating facilities often require a decade, or more, to build. During these time periods, there are unavoidably changes that can profoundly affect capacity planning decisions. There can be changes in a utility system's anticipated future demand for electricity. There can be changes in the relative costs of alternative generating facilities (and the fuels used in them). There can be changes affecting a utility's ability to obtain needed capacity by entering into long-term contracts with other utilities. The way in which a utility system responds to these changing conditions determines its costs—and its customers' rates.

prudence" that FERC "has adopted" in regulating wholesale rates and power supply arrangements.[28]

Indeed, when the prudence claims are raised,[29] FERC exercises jurisdiction to decide any and all claims that a utility behaved imprudently after construction of a plant was "underway." FERC decides claims that the utility's conduct in managing construction of the plant was wasteful or inefficient.[30] FERC decides claims that a prudent utility would have minimized its losses by cancelling a plant[31] or by cancelling it at an earlier point in time.[32] FERC further decides the very kinds of prudence claims that the Council has raised: that utilities should have recognized the risks created by events like the Three Mile Island accident and sought to "minimize their losses" by selling off their entitlements to power from a plant and/or obtaining substitute power from

[28]*See* J.A. 92 & n.25, *quoting New England Power Co.*, 31 FERC ¶ 61,047 at 61,084 (1985) (FERC reviews "prudence" of "utility's actions and the costs resulting therefrom" by asking what "a reasonable utility management" would have done "in good faith, under the same circumstances, and at the relevant point in time").

[29]Under FERC's practice, an investment is presumed to be prudent unless a party raises prudence objections or a serious doubt about the prudence of an investment is otherwise raised. *See, e.g., Minnesota Power & Light Co.*, 11 FERC ¶ 61,312 at 61,645 (1980).

[30]*Kansas Gas & Electric Co.*, 49 FERC ¶ 61,295 at 62,117 (1989) (disallowing some of the costs of construction of the plant on grounds of imprudence); *Union Electric Co.*, 40 FERC ¶ 61,046 (1987) (same), *rev'd on other grounds*, 890 F.2d 1193 (D.C. Cir. 1989).

[31]*Kansas Gas & Electric Co.*, 39 FERC ¶ 63,013 at 65,065-69 (1987), *aff'd*, 49 FERC ¶ 61,295 (1989) (rejecting claims that it was imprudent to continue construction of plant, rather than to cancel it or reduce its size); *Union Electric Co.*, 35 FERC ¶ 63,076 at 65,238-41 (1986).

[32]*New England Power Co.*, 32 FERC ¶ 61,112 (1985) (rejecting claims it was imprudent to fail to minimize losses by ending investment in cancelled Pilgrim II plant earlier), *aff'd sub nom., Violet* v. *FERC*, 800 F.2d 280 (1st Cir. 1986); *see Eastern Edison Co.* v. *Department of Public Utilities*, 446 N.E.2d 684 (Mass. 1984) (recognizing that a state utility commission can raise such prudence claims before FERC).

alternative sources.[33] FERC also exercises jurisdiction to decide prudence claims that are the converse of those presented here: that a utility was imprudent in selling off or cancelling a nuclear plant and deciding to obtain capacity from alternative coal sources instead.[34]

FERC makes these determinations in setting wholesale rates and in allocating costs both among participating utilities and between ratepayers and shareholders. Indeed, FERC has exercised jurisdiction to review the "prudence of [a utility's] action in keeping, rather than selling, [a nuclear] plant" even before the utility actually seeks to recover its costs in wholesale rates.[35]

Finally, there is no substance to the Council's efforts to distinguish these cases and to avoid the plain terms of the Federal Power Act. FERC has jurisdiction to review the prudence of any

[33]*Connecticut Light & Power Co.*, 43 FERC ¶ 63,029 at 65,228, 65,231 (1988), *aff'd* 48 FERC ¶ 61,139 (1989) (deciding claims that prudent utility would have sold off entitlements to Millstone 3 and obtained power from alternate sources such as Canadian electricity and cogeneration); *Arizona Public Service Co.*, 25 FERC ¶ 63,025 at 63,055-57 (1983), *aff'd*, 27 FERC ¶ 61,185 (1984) (deciding claims that a prudent utility should sell-off part of plant); *see AEP Generating Co.*, 35 FERC ¶ 61,226 at 61,549 (1986) & *AEP Generating Co. and Kentucky Power Co.*, 38 FERC ¶ 61,243 (1988) (reviewing prudence of participating utility's decision to purchase output of system plant "in light of the availability of alternate power sources").

[34]*Northern States Power Co.*, 17 FERC ¶ 61,196 (1981) (rejecting claim that it was imprudent to cancel the Tyrone nuclear plant and to obtain coal-fired power instead), *aff'd sub nom., South Dakota Public Utilities Comm'n* v. *FERC*, 690 F.2d 674 (8th Cir. 1982); *see Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32, 38 (N.D. 1981) (recognizing FERC's exclusive jurisdiction "to determine the reasonableness and prudence of the Tyrone loss"); *Northern States Power Co.* v. *Minnesota Public Utilities Comm'n*, 344 N.W.2d 374 (Minn. 1984) (same).

[35]*Arizona Public Service Company*, 27 FERC ¶ 61,185 at 61,350 (1984); *Arizona Public Service Company*, 21 FERC ¶ 63,007 (1982), *aff'd*, 23 FERC ¶ 61,419 (1983.

decision or action of a wholesale utility that affects the utility's costs, be it the construction or cancellation of a generating facility or the acquisition or sale of generating capacity through contracts.[36]

II. The Fifth Circuit's Holding Is Contrary to *MP&L*, *Nantahala*, And Their Numerous Precursors.

For these reasons, *MP&L*, *Nantahala*, and this Court's other prior preemption decisions each reject the Fifth Circuit's holding. They establish that FERC has exclusive jurisdiction to make all determinations required to assure that FERC rate schedules are "just, reasonable, and nondiscriminatory." Indeed, decades of prior decisions of this Court hold that states are preempted from

[36]In its Opposition to the petition for certiorari, the Council argued (pp. 3-4 & 15-17) that FERC has jurisdiction over decisions to "construct" or "cancel" a generating plant, but *not* over the utility's failure to pursue the "risk-reducing" measures of selling off an interest in the plant and buying substitute power from alternative sources. This claim is baseless. The prudence of decisions to contract with third parties to buy or sell capacity, like the prudence of decision to complete, or cancel a plant, is a matter that determines a utility's costs and the resulting rates. Thus, review of the prudence of *each* is encompassed within FERC's jurisdiction to assure that wholesale rates, and contracts affecting them, are just, reasonable, and nondiscriminatory.

Indeed, the Council's proposed distinction is refuted by the terms of its order. The Order states, correctly, that building plants and entering into contracts with unaffiliated utilities are simply alternative means by which utilities acquire the generating capacity they need to serve customers. J.A. 204. The FERC rate schedules so provide as well. *See* § 4.01 of 1973 System Agreement (J.A. 40-41) (equating construction of plant and acquiring capacity by "firm contract").

Finally, the Council is incorrect in asserting that the Act gives FERC jurisdiction over "construction" or "cancellation" of plants as such. To the contrary, FERC has no authority over "facilities used for the generation of electric energy" except as "specifically provided" elsewhere in the Act. Federal Power Act, §§ 201(b)(1) & 205; Cert. App. 36A. FERC thus can consider construction decisions only in connection with assuring the reasonableness of rates. *See MP&L*, 487 U.S. at 382-83 (Scalia, J., concurring).

taking any action, no matter how it is labeled,[37] that would have the *effect* of changing FERC-regulated rates (*Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571 (1981)), of altering FERC's interstate "allocations of costs" (*Maryland* v. *Louisiana*, 451 U.S. 725, 749-50 (1981)), or of imposing sanctions on conduct that federal agencies have jurisdiction to "declare unlawful or unreasonable." *Chicago & N.W. Transp. Co.* v. *Kalo Brick & Tile Co.*, 450 U.S. 311, 324-27 (1981).

In particular, the Court developed the "filed rate doctrine" to "enforce the exclusive jurisdiction vested by Congress in FERC." *Nantahala*, 476 U.S. at 966. Because "the 'filed rate' doctrine . . . holds that interstate power rates filed with FERC or fixed by FERC must be given binding effect by state utility commissions determining intrastate rates," the doctrine assures that FERC alone determines the reasonableness of bulk power supply arrangements. *Nantahala*, 476 U.S. at 962-67.

Nantahala and *MP&L* held that states are categorically preempted from doing what the Council's Order concededly does: preventing a utility from recovering, in retail rates, costs that FERC has ordered the utility to incur. Cert. App. 2A; J.A. 11. *Nantahala* prohibits this "trapping" of costs. It holds that "a state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price." *Nantahala*, 476 U.S. at 965.

[37]On this basis, states have been held to be preempted from applying their tax laws, contract remedies, tort laws, and anti-fraud provisions as well as their utility laws in ways that have the effect of intruding, directly or indirectly, on federal authority. *Northern Natural Gas Co.* v. *State Corp. Comm'n of Kansas*, 372 U.S. 84 (1963) (state utility laws); *Maryland* v. *Louisiana*, 451 U.S. 725 (1981) (state tax laws); *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571 (1981) (state contract remedies); *Chicago & N.W. Transp. Co.* v. *Kalo Brick & Tile Co.*, 450 U.S. 311 (1981) (state tort laws); *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246 (1951) (state anti-fraud provisions); *Schneidewind* v. *ANR Pipeline Co.*, 485 U.S. 293 (1988) (state utility laws.)

MP&L applied this principle to the very Grand Gulf costs at issue. It holds that a retail ratemaking body may not do what the Council has done: "bar regulated utilities from passing through to retail customers FERC-mandated wholesale rates." *MP&L*, 487 U.S. at 372.

The Fifth Circuit recognized the holdings of *MP&L*, *Nantahala*, and their precursors. Cert. App. 10A-15A; J.A. 19-24. However, it attempted to distinguish them on three separate grounds. Each is erroneous.

A. *Nantahala* And *MP&L* Establish FERC's Exclusive Jurisdiction Over Claims Of "Imprudence" After Plant Construction Has Begun.

First, the Fifth Circuit stated that *Nantahala* and *MP&L* involved the prudence of initial decisions to participate in a wholesale generating plant, not the prudence of decisions made after construction of the plant had begun. Cert. App. 15A-16A; J.A. 24-25. However, the Fifth Circuit has misread these decisions, and its holding cannot be the law.

Nantahala did not involve the prudence of an initial decision to participate in a plant. Rather, it arose from a wholesale transaction in which a North Carolina utility (Nantahala) and its affiliate (Tapoco) each transferred the output from previously-constructed generating facilities to TVA in exchange for fixed entitlements of TVA power. The FERC rate schedules and orders prescribed a particular allocation of this lower-cost entitlements power between Nantahala and Tapoco. However, the North Carolina Utilities Commission ("NCUC") refused to include the resulting costs in Nantahala's retail rates. It found that if Nantahala had not imprudently acted to benefit its shareholder (Alcoa), it would have avoided the earlier transactions through a "roll-in" with Tapoco in which the "various sources of power available to

Tapoco and Nantahala" would be "pooled" and "then allocated . . . according to [relative] demand." *Nantahala*, 476 U.S. at 959-60.

In short, the NCUC did exactly what the Council did here: it did not directly alter FERC's wholesale allocations, but it set retail rates "as if" Nantahala had previously engaged in wholesale transactions that gave it a different allocation of power than FERC had ordered.[38] This Court reversed that order. It held that FERC had exclusive jurisdiction to decide these prudence claims. It held that a state thus "may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate" and that this principle is fully applicable to costs that result from FERC's interstate power allocations. *Nantahala*, 476 U.S. at 970-71.

MP&L is even more clearly dispositive. There, this Court was reviewing a Mississippi supreme court decision that ordered the Mississippi Public Service Commission ("PSC") to conduct an investigation of the prudence of the same Grand Gulf costs at issue here. As the Council correctly stated in its *amicus curiae* brief in *MP&L*,[39] the Mississippi court's holding would have al-

[38]In *Nantahala* the NCUC set retail rates as if wholesale power costs that FERC allocated to Nantahala had been allocated to its affiliate Tapoco. Here, the Council has set NOPSI's retail rates as if over $135 million of the Grand Gulf costs that FERC allocated to NOPSI had been allocated, instead, to the Council's hypothetical "sucker" utility. *See NOPSI*, 491 U.S. at 357 n.2.

[39]Because the Council had then completed the same kind of prudence investigation that the Mississippi supreme court had ordered, the Council filed *amicus curiae* briefs in *MP&L* that argued that at least some state investigations of the prudence of the Grand Gulf 1 expenses of MSU operating companies are not preempted by the Federal Power Act and that the Court should allow the Mississippi prudence investigation to proceed. Brief Of Council Of City Of New Orleans As Amicus Curiae, *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, No. 86-1970, p. 10 (filed January 22, 1988).

lowed the entry of an order, on remand, that disallowed some, or all, of these costs under the same theory that the Council's Order adopted.

Indeed, contrary to the Fifth Circuit's holding, the Mississippi supreme court had directed a prudence investigation that focused solely on decisions made while construction of the plant was "underway." The Mississippi supreme court did not question the prudence of the initial 1974 decision to build Grand Gulf (or of MP&L's earlier decision to participate in the MSU power pool). Rather, the Mississippi court stated that it had become "obvious" by "the early 1980s, that both the cost and demand projections related to Grand Gulf were terribly incorrect," and it ordered a prudence "review" to determine "whether MP&L, MSEI and MSU acted reasonably when they constructed Grand Gulf 1, in light of the change in demand for electric power . . . and the sudden escalation of costs." *Mississippi ex rel. Pittman* v. *Mississippi Public Service Commission,* 506 So. 2d 978, 986, 987 (Miss. 1987); *see MP&L,* 487 U.S. at 368.

If this Mississippi PSC prudence investigation had proceeded, it would have addressed whether MP&L or the other MSU companies had been imprudent in the early 1980s—while construction of the plant was underway—by failing to recognize the magnitude of the risks created by Three Mile Island and by failing to minimize their losses by cancelling or selling-off Grand Gulf and by relying on alternative power sources instead. The Mississippi PSC would then have decided the extent to which the Grand Gulf costs should be "trapped" and borne by the utility's shareholders, rather than "passed on to MP&L's retail customers" (*MP&L,* 487 U.S. at 372 n.12)—which is precisely how the Council has described its investigation. *See* p. 13, *supra.*

MP&L held that the Federal Power Act and the Supremacy Clause categorically bar a state from even conducting such a review of "MP&L's managerial prudence," regardless of the form

it took. 487 U.S. at 369. It held that a state retail ratemaking body may not do what the Council concededly did here: "enter an order 'trapping' the costs MP&L [and other MSU operating companies are] mandated to pay under the FERC order allocating Grand Gulf power or undertake a 'prudence' review for the purpose of deciding whether to enter such an order." *MP&L,* 487 U.S. at 372 & n.12.

In so holding, the Court made it explicit that any and all such "prudence" claims were matters that are within FERC's jurisdiction and that "FERC easily could have considered in determining whether to permit MSE to recoup 100% of the costs of Grand Gulf in the wholesale rates it charged to the four operating companies and in allocating Grand Gulf power" among those companies. *MP&L,* 487 U.S. at 375.[40] For example, the Council could have presented its claims that MSE, MSU, or NOPSI could have and should have reduced their costs in 1980 by engaging in the wholesale purchases and wholesale sales that the Council's Order assumes, and that the amount of the forgone "savings" should be borne by NOPSI's shareholders and excluded from rates. However, as this Court recognized in *MP&L,* the reason FERC did not address the prudence of the MSU companies in this respect was because New Orleans and the state parties "failed to raise the matter," not because FERC has not "asserted" this jurisdiction.[41]

As Justice Scalia stated in his concurring opinion, "[a]fter [*MP&L*], the battle will no longer be over who has jurisdiction, FERC or the states." *MP&L,* 487 U.S. at 383 (Scalia, J., concur-

[40]Indeed, the Court cited FERC opinions in which FERC decided state claims that a utility had been imprudent in failing to take certain steps to minimize its risks during construction of a nuclear plant. *See MP&L,* 487 U.S. at 375, *citing New England Power Co.,* 31 FERC ¶ 61,047 at 61081-84 (1985), *aff'd sub nom., Violet* v. *FERC,* 800 F.2d 280 (1st Cir. 1986).

[41]*Compare MP&L,* 487 U.S. at 375 (Opinion for the Court) & *id.* at 379-80 n.* (Scalia, J., concurring) (quoting colloquy with counsel for New Orleans), *with* Cert. App. 15A-16A, J.A. 24-25.

ring). *MP&L* establishes that FERC's jurisdiction is plenary. As Justice Scalia stated, FERC has "jurisdiction" to "determine whether [a power pool] venture was prudent as a whole," "to determine a fair allocation of the cost of the facility among the utilities in the pool," and even "to determine the prudence of a particular utility's [initial] participation in the pool." *MP&L,* 487 U.S. at 378 (Scalia, J., concurring) (emphasis deleted).

B. As In *MP&L* And *Nantahala,* The Prudence Disallowance Does Not Involve "Cost Savings In Other Areas."

Second, the Fifth Circuit sought to distinguish *MP&L* on the ground that the Council's prudence disallowance is "analogous" to the "exception" which this Court recognized in *Nantahala.* Cert. App. 17A-18A; J.A. 26. Specifically, the Fifth Circuit cited *Nantahala's* statements that increases in FERC-mandated wholesale costs need not result in dollar-for-dollar increases in retail rates if the retail utility has experienced "savings in other areas." *Nantahala,* 476 U.S. at 967-68.[42] However, as this Court made explicit in *Nantahala,* "such a divergence between wholesale and retail rates would occur only if costs *other than* those resulting from the purchase of FERC-regulated power or gas were to decrease," such as "costs of transformation and transmission." 476 U.S. at 967-68 (emphasis in original).

That principle is inapposite here for the same reason it was in *MP&L*: the Council's Order finds no such "savings in other areas." Rather, here, as in *MP&L* (*see* 487 U.S. at 365), all non-

[42]The Fifth Circuit stated that "[i]f states may deny [dollar-for-dollar] pass throughs because costs have gone down in other areas, it seems logical that they should be able to deny them because costs would have gone down if the utility had not been imprudent." Cert. App. 18A; J.A. 26. The fallacy of this statement is that the basis of the Council's order is not that a prudent utility would have achieved "cost savings in other areas." Rather, it is that a "prudent" utility would have *avoided* the costs FERC found just and reasonable and ordered the utility to incur.

Grand Gulf revenue requirements, and all available "savings in other areas," were finally determined in a separate retail rate order. *See* p. 13, *supra.* Accordingly, the Council's investigation and Order do precisely what *MP&L* and *Nantahala* forbid: they bar the recovery of the *Grand Gulf* costs that FERC regulates and that FERC found "just and reasonable" and ordered NOPSI to incur. *See* Cert. App. 2A; J.A. 11. Indeed, as explained below, the only way the Council could bar recovery of these costs is by collaterally attacking FERC's determinations and making findings that are inconsistent with FERC's actual and implicit determinations.

C. *MP&L* And *Nantahala* Were Not Overruled By This Court's Subsequent Abstention Opinion In This Case.

Finally, the Fifth Circuit sought to distinguish *MP&L* and *Nantahala* by relying on this Court's earlier abstention opinion in this case. In particular, although this Court's *holding* was that the federal courts erred in refusing to decide NOPSI's facial preemption claim, the Fifth Circuit has relied on the portions of this Court's opinion that indicated that *Younger* v. *Harris* would have required abstention in this case *if* the pending state judicial proceeding had been an enforcement proceeding—*e.g.,* a criminal prosecution for a violation of the rate order. *See* p. 16, *supra.* The Court indicated that such a federal suit could not be maintained because the Council's order is not "flagrantly and patently violative of express constitutional provisions in every clause, sentence, and paragraph." *NOPSI,* 491 U.S. at 366-67; *Younger,* 401 U.S. at 53-54. These latter statements "convinced" the Fifth Circuit "that the [Supreme] Court in *NOPSI III* did not believe that the Council could not regulate NOPSI's activities" in the way it did. Cert. App. 17A; J.A. 26.

The Fifth Circuit's conclusion is inexplicable. As the Fifth Circuit also stated, "[i]t is plain, however, that the [Supreme] Court held only that the [Council's] order was not 'flagrantly' unlawful for *Younger* abstention purposes; it did not hold the facial pre-

emption claim was foreclosed." Cert. App. 10A; J.A. 19. Indeed, the Fifth Circuit recognized that this Court had "reversed" the Fifth Circuit's decision for failing to decide this facial preemption claim. Cert. App. 9A; J.A. 18.

Further, while only this Court can know what it meant in this passage from *NOPSI III,* this Court's language, by its terms, does not even address the NOPSI claim that the Council's Order is preempted on its face by the *orders* FERC entered under the Federal Power Act.[43] Rather, by its terms, the Court's discussion confined any such exception to *Younger* v. *Harris* to a narrow set of claims that are preempted by the Federal Power Act by its own force: *e.g.,* when a state directly regulates wholesale rates. *See, e.g., Public Utilities Comm'n of Ohio* v. *United Fuel Gas Co.,* 317 U.S. 456 (1943). In all events, if this Court's abstention discussion had been intended to bar NOPSI's facial preemption claim, it would, as explained above, have overruled *MP&L, Nantahala,* and decades of prior preemption decisions, without saying so and while explicitly declining to decide the merits of the preemption issues. *See NOPSI,* 491 U.S. at 353.

[43]The Fifth Circuit relied on the Court's statement that the Council had disallowed costs because it found the utility had imprudently failed to "diversify its supply portfolio" and that "[n]othing in this is directly or even indirectly foreclosed by the federal statute [*i.e.,* 16 U.S.C. §§ 791-828], the regulations implementing it [*i.e.,* 18 C.F.R. §§ 4-141], or the case law applying it." *NOPSI,* 491 U.S. at 367; *see* Cert. App. 15A, 17A; J.A. 24, 26. By its terms, this statement does no more than reflect the holdings that the Federal Power Act allows states to disallow costs that a utility *voluntarily* incurs in purchasing energy under FERC rate schedules: that is, when (as is not the case here) the purchase was not part of a pooling arrangement, the utility was not both a wholesale and a retailer, and FERC did not *order* the utility to purchase a particular *quantity* of energy at a FERC-approved rate in regulating the wholesale transactions. *See Kentucky W. Va. Gas Co.* v. *Pennsylvania Public Utility Comm'n,* 837 F.2d 600 (3d Cir. 1988); *MP&L,* 487 U.S. at 373-74; *Nantahala,* 476 U.S. at 972-73. By contrast, NOPSI's facial preemption claim here rests on the valid FERC *orders* that require NOPSI to buy 17% of Grand Gulf at FERC-approved rates.

III. The Council's Order Has Relitigated The Very Matters That Were Before FERC And Has Collaterally Attacked FERC's Findings.

Finally, in any case, the Council's Order is precisely the kind of state action that the Federal Power Act must be held to preempt under any reading of *NOPSI III.* As FERC and the Solicitor General have stated,[44] the Council's Order does not merely decide claims that could be presented to FERC. It has relitigated the reasonableness of the "same activit[ies]" that were before FERC (*Kalo Brick,* 450 U.S. at 319) and "collaterally attacked" not only "[t]he reasonableness of rates and agreements regulated by FERC" (*MP&L,* 487 U.S. at 375), but also many of FERC's actual and implicit findings. This epitomizes the evils that the Federal Power Act was intended to prevent, and constitutes an independent ground for holding the Council's Order "invalid on its face." *NOPSI,* 491 U.S. at 363.[45]

A. The Council Findings And Assumptions Are Inconsistent With FERC's Orders In Three Fundamental Respects.

There are three fundamental respects in which the Council has relitigated the very matters that were before FERC and that FERC decided.

[44]Feb. 1991 FERC Amicus Br., pp. 11-17.

[45]The Fifth Circuit did not decide this separate facial preemption claim because the Fifth Circuit concluded, again, that this Court rejected it *sub silentio* in its abstention opinion in this case. Cert. App. 16A n.5; J.A. 25 n.5. However, this Court's abstention opinion explicitly did not consider challenges to the Council's "necessary factual finding[s]" (*NOPSI,* 491 U.S. at 367), but indicated at most that a retail rate order cannot be "flagrantly and patently" unlawful to the extent that the challenges to it depend on examining findings made in over 500 pages of FERC opinions. *Id.*

1. The Council Has Collaterally Attacked The Reasonableness Of NOPSI's 17% Allocation.

First, the Council's Order is a collateral attack on FERC's determination that NOPSI's purchase of 17% of Grand Gulf at FERC-approved rates is "just and reasonable." *MP&L*, 487 U.S. at 375. FERC made these determinations in a proceeding in which FERC had before it (1) all the MSU system's decision-making between 1970 and 1985, (2) all the power sources on the MSU system, and (3) New Orleans's claims that FERC was giving NOPSI too much nuclear investment relative to its size and too little coal.

The Council's Order replows this same ground. The Order, too, is predicated on the premise that NOPSI now has too much nuclear power relative to its size and too little coal—which is the claim FERC rejected.[46] Further, what the Council finds is that NOPSI was imprudent in failing to anticipate that it "would be required [by FERC] to take some portion of Grand Gulf as a matter of system responsibility" and in then seeking to *avoid* the allocations that FERC found "just and reasonable." J.A. 71-72. Finally, and most fundamentally, the Council makes this finding by reviewing the *same* evidence of the MSU system's Grand Gulf decisionmaking between 1970 and 1985 that was before FERC and by making findings that are the *opposite* of FERC's.

The linchpin of the Council's Order is its determination that, if NOPSI had been "prudent" in 1980, it would have concluded that the MSU system's estimates of the likely costs of Grand Gulf and alternative coal power were wrong and that Grand Gulf

[46]Indeed, FERC rejected New Orleans's claim that NOPSI should receive only 9% of Grand Gulf and should not, in any case, receive its proportionate share of the system's nuclear investment costs unless FERC equalized non-nuclear costs (and gave NOPSI more low-cost coal). *See* pp. 10-12, *supra*.

power would be excessively priced relative to coal power. J.A. 132-34 & 171-208. It is for *that* reason that the Council found NOPSI should have sold off 8% of Grand Gulf power and replaced it with equivalent amounts of lower cost coal power. *See* p. 15, *supra*.

However, the same MSU system cost estimates were before FERC (*see* p. 8, *supra*) and FERC found precisely the opposite: that MSU officials were "prudent" in believing that Grand Gulf would "produce power for a total cost (capacity and energy) which would be less than existing alternatives on the system." *MP&L*, 487 U.S. at 363. Under this finding, there was no reason or basis to sell-off any Grand Gulf power and to buy substitute coal-fired power instead.

Further, the Council's Order rests on the ground that NOPSI should not have had more than 9% of Grand Gulf because that, in the Council's view, is the share justified by NOPSI's "relative" size. *See* p. 15 & n. 20, *supra*. However, that is the very claim the Council made to FERC and that FERC rejected in finding that a 17% allocation is "just and reasonable." *See* pp. 10-12, *supra*.

Indeed, the Council's defense of its Order is an admission that it has collaterally attacked FERC's determinations. The Council has defended its Order on the ground that it is not disputing FERC's finding that it is "just and reasonable" and prudent for NOPSI to have *obtained* 17% of Grand Gulf "for resale" to retail customers. Instead, the Council claims that the basis for its Order is that it was "imprudent" for NOPSI to *retain* the power and in fact resell it to retail customers, rather than to sell it off to a hypothetical "sucker" utility. But that is a distinction without a difference, and this Court has held that the preemptive effect of FERC orders cannot be evaded through facile distinctions and "artful pleading." *Kalo Brick*, 450 U.S. at 324.

2. The Council Has Collaterally Attacked The Joint Planning Requirements.

Second, here, as in *MP&L*, the Council has collaterally attacked FERC's determination that "the Middle South companies appropriately approach power planning on a system wide basis" and that the reasonableness of purchases of Grand Gulf power cannot be assessed "in light of local conditions" in any one jurisdiction alone. *MP&L*, 487 U.S. at 376 (citations omitted).

In particular, here, too, the Council does not purport to challenge FERC's finding that the MSU system's retention of a 90% interest in Grand Gulf was a reasonable means of diversifying fuel sources to meet MSU system needs "as a whole." But the Order rests on the premise that NOPSI should have discharged its "independent" obligations to New Orleans ratepayers by unilaterally seeking to diversify *its* "power supply portfolio" in a different way than the MSU system had directed. The Order thus repeatedly excoriates NOPSI for relying on the system's cost estimates—which the Council calls an " 'Ostrich' Policy"—and for not itself replicating the system's capacity planning process, "critically" second guessing the system's decisions, and seeking to nullify them.[47]

However, the Council's findings are preempted on two grounds. First, the FERC rate schedules in effect in 1979 and 1980 required system-wide planning and foreclosed individual MSU operating companies from engaging in the hypothesized off-system wholesale purchases and sales without System approval. *See* pp. 5-6, *supra*. Second, FERC found that the Grand Gulf

[47]J.A. 120, 161-67 & 171-208. The Council's theory is that FERC can find that the MSU system's retention of its 90% interest in Grand Gulf was a reasonable means of fuel diversification for the MSU system as a whole, but the five different state and local ratemaking bodies can revisit this issue and find, based on "local conditions," that individual MSU operating companies should have second-guessed the system's planning process, anticipated FERC's allocation, and sought to nullify both.

planning was an appropriate means of serving the needs of the system as a whole.[48] *See* 32 FERC at 61,958.

3. The Council Has Collaterally Attacked FERC's Cost Allocation Principles.

Finally, the Council's Order *assumes* that NOPSI and its ratepayers would have realized the resulting "savings" if NOPSI had engaged in the hypothesized 1980 wholesale sale of 8% of Grand Gulf and a wholesale purchase of equivalent amounts of lower-cost coal. In particular, the Council assumes FERC would then have allowed NOPSI to avoid 8% of Grand Gulf's costs and to achieve dramatically lower nuclear capacity costs than the other MSU companies. But this assumption, too, is foreclosed by FERC's contrary determination and epitomizes the speculation that the filed rate doctrine forbids.

In its orders, FERC adopted a Grand Gulf allocation that would equalize nuclear investment costs among the MSU companies. It recognized that some of the system's nuclear investment had been sold to Mississippi utilities, but it equalized those nuclear investment costs that remained on the system among the four MSU operating companies. In this regard, FERC *rejected* each and every argument under which any MSU company could have achieved dramatically lower nuclear investment costs relative to its average peak demand. *See* p. 11 & n.13, *supra*.

In particular, FERC rejected a claim of the Arkansas parties that is virtually identical to the claim New Orleans would have made if NOPSI had engaged in the hypothetical wholesale trans-

[48]Indeed, the Council's collateral attack on these binding FERC schedules is especially improper because the Council has *not* challenged NOPSI's initial decision to participate in this power pooling arrangement. Rather, the Council appears to recognize that system-wide planning has led to efficiencies and reductions in "unit costs" that would have been unobtainable by NOPSI or any individual MSU operating company. *See* J.A. 108 (quoting SEC Order to this effect). The Council's theory is that NOPSI can participate in the power pool for some purposes, but selectively "opt out" in light of "local conditions." That theory would destroy integrated power systems.

actions in 1980. The Arkansas parties claimed that AP&L should have no Grand Gulf allocation because it had "independently" acquired sufficient base load coal and nuclear capacity to meet its own needs prior to 1980 and because it had contracted away all its Grand Gulf 1 entitlements to other MSU companies. Indeed, the Arkansas parties claimed that FERC had no jurisdiction to order the "forced purchase" of that percentage of Grand Gulf that was required to give AP&L its fair share of the system's nuclear investment. FERC rejected these arguments and held it is essential that AP&L, like each other MSU operating company, bear its proportionate share of the system's nuclear investment, regardless of the transactions that each had entered into in 1980 or in any years prior to 1985. 32 FERC at 61,957-58; 26 FERC at 65,113-19.

In short, FERC adopted a rule in 1985 in which allegedly "independent" sales and acquisitions of other capacity by an individual MSU company could not reduce its and its ratepayers' proportionate shares of the MSU system's nuclear investment costs. Accordingly, one of the critical assumptions of the Council's Order is that FERC would have departed from these principles in its 1985 order if NOPSI had engaged in the hypothetical transactions in 1980.

As this Court has held, such an assumption is "precisely what the filed rate doctrine [and settled preemption principles] forbid[ ]." *Arkansas Louisiana Gas Co.* v. *Hall,* 453 U.S. 571, 579 (1981). "[I]t amounts to nothing less than the award of a retroactive rate [reduction] based on *speculation* about what the Commission might have done had it been faced with the facts of this case." *Id.* at 578-79 (emphasis added).[49] As FERC and the Solicitor General have stated, FERC alone may decide the question of "how the benefits and burdens of [power] sources should be shared between affiliated companies doing business in different States." Feb. 1991 FERC Amicus Br., p. 12.

[49]The rule of *Arkansas Louisiana Gas* also prohibits other critical assumptions of the Council's Order: that FERC would in 1980 have approved the hypothetical wholesale purchases of coal and sales of nuclear power at prices that the Council's Order assumes. Indeed, the Council has never disputed that FERC would have had jurisdiction over these transactions.

B. Such Collateral Attacks Are Facially Preempted By FERC's Orders.

Because the Council has relitigated the very matters that FERC actually and implicitly decided, its Order epitomizes the state action that is preempted by the Federal Power Act. As the New Hampshire Supreme Court has stated, it would "defeat part of the federal objective of providing orderly and streamlined procedures for approval of wholesale transactions" if each affected state could relitigate matters FERC decided and trap FERC-mandated costs. *Appeal of Sinclair Machine Products, Inc.,* 126 N.H. 822, 830, 498 A.2d 696, 702 (1985).

Indeed, the Council's Order demonstrates that the potential for subversion of the Federal Power Act is unlimited under the "exception" that the Fifth Circuit has recognized. It is always possible to make (or contrive) a finding that a prudent utility should have minimized the "losses" resulting from an unfavorable FERC allocation by selling off high-cost power and by purchasing lower-cost power years before the allocation was established.

The Council's Order proves the point. It is not based merely on findings that are contradicted by FERC's. The Council's findings are so plainly contrary to the Council's other determinations —and so implausible on their face—that the District Court earlier said that the Council's findings were "pulled from thin air" and are a transparent attempt to achieve the 9% allocation that FERC rejected. *NOPSI,* 491 U.S. at 357 n.2 (quoting District Court).

For example, the Council found NOPSI could have and should have sold all but 9% of Grand Gulf at a time when NOPSI did not know what its allocation would be and when the allocation could have realistically ranged from 9% to 29.8%—and theoretically could have been any number. Further, notwithstanding the Council's finding that it was imprudent for NOPSI to have this "indeterminate" Grand Gulf commitment in 1980 (J.A. 155-61, 197-203), the Council finds that there is a "sucker" utility who could have *prudently* then bought all but 9% of NOPSI's indeterminate share. However, the Council has never identified a *single* such utility, but *assumes* its existence by repeatedly citing statements of NOPSI's President in 1980 that are irrelevant by their very terms.[50]

Further, unless such orders are held facially preempted, this case shows that the consequences could be severe. To date, Louisiana courts have affirmed the Council's findings that support a $135 million disallowance on the ground that NOPSI did not bear its "burden" of disproving the Council's assumptions. Further, the Louisiana courts have to date held, as a matter of state law, that the prudence disallowance at issue must be increased to $425.38 million (plus carrying costs)—which would render NOPSI insolvent. *See* pp. 19-20, *supra*.

In this regard, the issue before this Court is not who is right or who is wrong about the facts in 1980: FERC or the Council. Nor

[50]NOPSI's President (James Cain) then stated that *"if"* the Council later disapproved NOPSI's participation in Grand Gulf 1 (as it has not even today), "*then* NOPSI has the option of selling the capacity and marketing it . . . to other electric utilities" and that Mr. Cain believed the power would be "attractive." J.A. 202-03; *see* J.A. 141-43. This statement reflects the MSU system's belief in 1980 that the overall generation costs of Grand Gulf would be lower than any existing alternative. *See* p. 7 n.9, *supra*. But *that* is the belief that the Council found to be "imprudent" and the Council's repeated reliance on this statement to show that a "prudent" buyer existed is the sheerest sophistry.

Most fundamentally, however, *MP&L* explicitly rejected the contention that such representations can "subvert the operation of the Supremacy Clause" and "equitably estop[ ]" a utility from obtaining an order that such prudence disallowances are preempted. *Compare MP&L*, 487 U.S. at 376-77 n.14, *with* J.A. 202-03.

is the issue whether the Council's contrived findings are minimally rational under state law or sustainable under any theory. Rather, it is who is to have jurisdiction to make these determinations and, in particular, whether it would frustrate the regulatory scheme of the Federal Power Act to allow states to nullify the choices FERC has made through such orders. As *MP&L* and *Nantahala* recognize—and as FERC here argues—the answers to these questions are clear: the Federal Power Act gives FERC exclusive jurisdiction over all such prudence claims and must preempt the states from entering orders trapping FERC-mandated costs on any such grounds.

CONCLUSION

For the reasons stated, the judgment of the United States Court of Appeals for the Fifth Circuit should be reversed and the case should be remanded for the entry of a judgment for NOPSI.

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QUESTIONS PRESENTED

1. Whether a FERC order, allocating the power and costs of a nuclear plant among affiliated operating companies, "facially" preempted a state prudence order that adjusted one such company's retail rates to reflect its negligence in failing to reduce its risks and, on *factual* findings not contestable here,

(a) the company could have sold off power to reduce its risks and still have complied with FERC's orders;
(b) the company said it could make such sales but was negligent in failing to do so;
(c) such sales, would have significantly lowered the company's costs,

and where this Court previously stated that, "Nothing in this is directly, or even indirectly, foreclosed" by federal law and remanded for "further factual inquiry." *New Orleans Public Service, Inc. v. Counsel of the City of New Orleans*, 491 U.S. 350, 367 (1989); and where the issue could not properly have been raised at FERC.

2. Whether the federal district court should have determined the merits hereafter a state court of competent jurisdiction had entered a final judgment determining such merits, in that Section 1738 of Title 28 U.S.C. required the federal court to give the same "credit" to said judgment as due within the state, and state law made such judgment "conclusive" of all similar actions between the same parties and required their dismissal.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
TABLE OF CONTENTS	ii
TABLE OF AUTHORITIES	iv
COUNTERSTATEMENT OF THE CASE AND PROCEEDINGS BELOW	1
1. The Parties	1
2. Characteristics of the "System"	2
3. Grand Gulf I and Other Generation Additions	5
4. 1980 Hearings Before the Council	8
5. The FERC Proceedings	9
6. CNO's Position and the Judicial Review of the FERC's Order	11
7. NOPSI's Rate Application and the Filing of *"NOPSI I"*	12
8. The Prudence Inquiry	15
9. This Action and Related State Court Proceedings	17
SUMMARY OF ARGUMENT	19
ARGUMENT	21
I. *NOPSI III* Left Virtually No Room For A "Facial" Disposition Of The Case; Moreover, It Did Not Anticipate That There Would Be Further Fractionated Consideration Of The Matter	21
A. The Decision In *NOPSI III*	21
B. The District Court Should Not Have Proceeded To A Fractionated Disposition, In Light Of The Prior State Court Judgment	25

II. The Council Acted Properly On A Matter Within Its Lawful Jurisdiction, And The FERC May Not Expand Its Authority To Encroach Upon That Jurisdiction	29
A. The Legislative History Of The Federal Power Act Explicitly Contradicts Petitioner's Position	29
B. There Is No Substantive *Or* Jurisdictional Conflict Between The Council And FERC's Actions	33
1. The Council's Order Properly Addressed Matters Within Its Jurisdiction	33
2. The FERC Did Not and Could Not Address the Issues Addressed By The Council	33
3. The FERC's New "Jurisdictional" Position Would Encroach Upon State Regulatory Rights	38
4. The *MP&L* And *Nantahala* Decisions Do Not Foreclose The Council's Actions	41
5. There Are No Substantive Conflicts Between The Decisions of The Council And FERC	43
CONCLUSION	48

TABLE OF AUTHORITIES

CASES:	Page
Alliance for Affordable Energy, Inc. v. Council of New Orleans, 578 So. 2d 949 (La. Ct. App. 4th Cir. 1991)	17,19,24,28,40
Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571 (1981)	31,48
Bailey v. Ness, 733 F.2d 279 (3d Cir. 1984)	27
Boissiere v. New Orleans Pub. Serv. Inc., No. 88-2503 (La. Civ. Dist. Ct. filed Feb. 4, 1988)	17
Burford v. Sun Oil Co., 319 U.S. 315 (1943)	22
City of New Orleans v. FERC, 875 F.2d 903 (D.C. Cir. 1989), *cert. denied*, 110 S. Ct. 1805 (1990)	12
Federal Power Comm'n v. Southern Cal. Edison Co., 376 U.S. 205 (1964)	29
Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132 (1963)	32
Giulini v. Blessing, 654 F.2d 189 (2d Cir. 1981)	27
Glen Oaks Util. Inc. v. City of Houston, 280 F.2d 330 (5th Cir. 1960)	27
Gulf States Util. Co. v. LPSC, 578 So. 2d 71 (La. 1991)	17,18
Hines v. Davidowitz, 312 U.S. 52 (1941)	32
Hospital Corp. of Am. v. Robinson, 506 So. 2d 938 (La. Ct. App. 1987)	26
Jones v. Rath Packing Co., 430 U.S. 519 (1977)	32
Middle South Energy, Inc. and New Orleans Pub. Serv. Inc. v. City of New Orleans, No. 85-5273 (E.D. La. Dec. 19, 1986), *aff'd*, *New Orleans Pub. Serv. Inc. v. City of New Orleans*, 833 F.2d 583 (5th Cir. 1987)	10
Mississippi Indus. v. FERC, 822 F.2d 1104 (D.C. Cir. 1987), *cert. denied*, 484 U.S. 985 (1987)	11
Mississippi Indus., Inc. v. FERC, 808 F.2d 1525 (D.C. Cir.), *vacated in part*, 822 F.2d 1104 (D.C. Cir. 1987), *cert. denied*, 484 U.S. 985 (1987)	5,12,13

Table of Authorities Continued

	Page
Mississippi Power & Light Co. v. Mississippi ex rel. Moore 487 U.S. 354 (1988)	21,34,35,41,42,43,46
Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953 (1986)	21,41,42
NOPSI v. Council of New Orleans, No. 85-3398, slip op. (E.D. La. Sept. 16, 1985), *aff'd*, 798 F.2d 858 (5th Cir. 1986), *modifying* 782 F.2d 1236 (5th Cir.), *cert. denied*, 481 U.S. 1023 (1987)	13
NOPSI v. Council of New Orleans, No. 88-4511, slip op. (Civ. Dist. Ct. May 5, 1988), *aff'd*, No. 88-CA-1369 (La. Ct. App. Feb. 16, 1989)	17,24
NOPSI v. Council of New Orleans, 491 U.S. 350 (1989)	14,16,19,21,22,23,24,25,28,32,33,38,41,43
NOPSI v. Council of New Orleans, No. 88-559, slip op. (E.D. La. Mar. 10, 1988)	17
NOPSI v. Council of New Orleans, No. 88-559, slip op. (E.D. La. Jan. 4, 1990)	25
NOPSI v. Council of New Orleans, No. 88-4511, slip op. (La. Civ. Dist. Ct. Nov. 15, 1989)	17,24
Northwest Cent. Pipeline Corp. v. State Corp. Comm'n, 489 U.S. 493 (1989)	32
Ollie v. Riggin, 848 F.2d 1016 (9th Cir. 1988)	27
Panhandle Eastern Pipeline Co. v. Public Serv. Comm'n of Indiana, 332 U.S. 507 (1947)	31
Pike County Light & Power Co. v. Pennsylvania Pub. Util. Comm'n, 465 A.2d 735 (1983)	42
Public Util. Comm. v. Attleboro Steam & Elec. Co., 273 U.S. 83 (1927)	29
Ramshur v. Allstate Insurance Co., 288 So. 2d 428 (La. Ct. App. 1973), *rev'd on other grounds, sub nom. Sauce v. Bustell*, 298 So. 2d 832 (La. 1974)	26

Table of Authorities Continued

	Page
Ray v. Hasley, 214 F.2d 366 (5th Cir. 1954)	27
Rice v. Santa Fe Elevator Corp., 331 U.S. 218 (1947)	32
Ward v. Pennington, 523 So. 2d 1286 (La. 1988)	26
Wisconsin Pub. Intervenor v. Mortier, 111 S. Ct. 2476 (1991)	32
Younger v. Harris, 401 U.S. 37 (1971)	22
ADMINISTRATIVE DECISIONS:	
Arizona Pub. Serv. Co., 23 FERC ¶ 61,419 (1983), *summarily aff'g*, 21 FERC ¶ 63,007 (1982)	37
Arizona Pub. Serv. Co., 27 FERC ¶ 61,185 (1984)	37
Connecticut Power & Light Co., 43 FERC ¶ 63,029 (1988), *aff'd*, 48 FERC ¶ 61,139 (1989)	36
Middle South Energy, Inc., 26 FERC ¶ 63,044 (1984)	4,5,8,9,10,11,46,47
Middle South Energy, Inc., 30 FERC ¶ 63,030 (1985)	3
Middle South Energy, Inc., Opinion 234, 31 FERC ¶ 61,305, *aff'd*, 32 FERC ¶ 61,425 (1985)	2,3,5,7,9,10,11,33,45,46,47,48
Middle South Energy, Inc., Opinion 234-A, 32 FERC ¶ 61,425 (1985)	3,4,5,9,10,33,45,48
Minnesota Power & Light Co., 11 FERC ¶ 61,312 (1980)	37
Monongahela Power Co., 39 FERC ¶ 61,350 (1987)	34,35,44
New England Power Co., 32 FERC ¶ 61,112 (1985), *aff'd sub nom., Violet v. FERC*, 800 F.2d 280 (1st Cir. 1986)	37

Table of Authorities Continued

	Page
New England Power Co., 42 FERC ¶ 61,016 (1988)	37
New England Power Co., 8 FERC ¶ 61,054 (1979), *aff'd sub nom., NEPCO Municipal Rate Comm. v. FERC*, 668 F.2d 1327 (D.C. Cir. 1981), *cert. denied*, 457 U.S. 1117 (1982)	37
Northern States Power Co., 17 FERC ¶ 61,196 (1981), *aff'd sub nom., South Dakota Pub. Util. Comm'n v. FERC*, 690 F.2d 674 (8th Cir. 1982)	37
Public Service Co. of Indiana, 51 FERC ¶ 61,637 (1990)	39
Southern California Edison Co., 8 FERC ¶ 61,198 (1979), *aff'd sub nom., Anaheim, Riverside v. FERC*, 669 F.2d 799 (D.C. Cir. 1981)	37
System Energy Resources, Inc., 41 FERC ¶ 61,238 (1987), *aff'd, City of New Orleans v. FERC*, 875 F.2d 903 (D.C. Cir. 1989), *cert. denied*, 484 U.S. 985 (1990)	11,12
Union Electric Co., 40 FERC ¶ 61,046 (1987)	37
STATUTES:	
15 U.S.C. § 717f	34
15 U.S.C. §§ 79-79z-6	4,31
16 U.S.C. § 824	20,29,30,34
28 U.S.C. § 1342	28,31
28 U.S.C. § 1738	19,26,27
La. Code Civ. Proc. Ann., art. 531	19,26
La. Code Civ. Proc. Ann., art. 532	27
La. Code Civ. Proc. Ann. art. 1841	26
La. Civ. Code Ann. art. 3556(31)	26
Louisiana R.S. 13:4231	27
MISCELLANEOUS:	
Electric Util. Week, Feb. 6, 1989	41

Table of Authorities Continued

	Page
Powerplant Costs: Hearing Before the Subcomm. on Energy Conservation and Power of the House Comm. on Energy and Commerce, 99th Cong., 2d Sess. (1986)	11
Public Utility Holding Company Act of 1935: Hearings on S. 1725 Before the Senate Comm. on Interstate Commerce, 74th Cong., 1st Sess. (1935)	30
Public Utility Holding Companies: Hearings on H.R. 5423 Before the House Comm. on Interstate and Foreign Commerce, 74th Cong., 1st Sess. (1935)	29
Regulation of Electricity Sales-For-Resale and Transmission Service, FERC Statutes and Regulation ¶ 35,519 (1985)	37
S. Rep. No. 621, 74th Cong., 1st Sess. (1935)	30,31
H.R. Rep. No. 1318, 74th Cong., 1st Sess. (1935)	29,30
78 Cong. Rec. 8335 (1934)	31
78 Cong. Rec. 2038 (1934)	28
C. Wright, A. Miller & G. Cooper, 18 Federal Practice & Procedure, § 4433	27

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

No. 90-1156

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *ET AL.*
Respondents.

BRIEF OF RESPONDENTS,
THE COUNCIL OF THE CITY OF NEW ORLEANS, *ET AL.*

STATUTORY PROVISIONS

The pertinent portions of federal and Louisiana statutes are reprinted as an Appendix hereto.

COUNTERSTATEMENT OF THE CASE AND PROCEEDINGS BELOW

Most of the factual matters described below are treated with more particularity in the prudence "Determinations and Order," J.A. 63-279, (hereinafter, the "Rate Order"). References to relevant sections of the Rate Order are thus set forth where appropriate.

1. The Parties [J.A. at 63-65]

The City of New Orleans is a Louisiana municipal corporation. The Council is invested with "all powers of supervision, regulation and control over any" public utility within the city. Its regulatory power is recognized by the Louisiana Constitution. J.A. at 63-64.

NOPSI[1] is engaged in the retail sale of electricity entirely in New Orleans. Its right to operate there derives from acts of the Council (and its predecessor) which authorize NOPSI "to charge and collect such fair and reasonable rates . . . as may be established by the City." J.A. 65.

NOPSI is a subsidiary of MSU, and is the smallest of the four MSU operating company subsidiaries. (The others, AP&L, LP&L and MP&L, provide service in neighboring regions and are separately regulated). MSE (now named "SERI") is MSU's generation subsidiary and owns a 90% interest in Grand Gulf.

2. Characteristics of the "System" [J.A. at 105-122]

Petitioner misportrays The MSU "system" as precluding the need for responsible managent of NOPSI, but it does not do so. The "system" is an electric "power pool" operated as a single integrated and highly coordinated system, J.A. 106—that is, the generating units of individual companies are interconnected by high voltage transmission lines, J.A. 106, and such units, each with a different operating cost, are centrally "dispatched" (brought into utilization) so as to reduce overall costs, J.A. 119. Decisions to build generation plants are based on all the companies' needs and made "for the system as a whole," *Middle South Energy, Inc.*, Opinion 234, 31 FERC ¶ 61,305, 61,650, *aff'd*, 32 FERC ¶ 61,425 (1985)—that is, a proposal for a new generation plant contemplates the projected "loads" of all companies, and this approach promotes such economies as are available in scale, fuel mix and site selection. (*Id.*)

However, each plant has been built, owned and operated by an operating company individually, except Grand Gulf, as described *infra*. J.A. 106. Each operating company has

[1] The names of the parties and the Middle South companies are abbreviated as in petitioner's brief. Petitioner is also referred to as NOPSI, and its brief is cited as "Pet. Br.." That of the Solicitor General as *amicus* is cited as "S.G. Br.."

been responsible for developing its own load forecast, which is combined with others by the Middle South Operating Committee ("MSOC"). J.A. 113-115. The MSOC makes an initial determination of the size and location of a new plant and assigns its construction to an individual company. J.A. 115. Each such company makes specific decisions as to the plant's size, location and type, and is responsible for financing and constructing it, or it may challenge the initial "system" assignment and propose another course. J.A. 114-115, 125-126; 31 FERC at 61,647-61,650, 61,653.

Each company's building a plant or contracting for power, or not doing so, have been the principal determinants of its power costs. J.A. 119. There has been a marked disparity among such companies' power costs, which has resulted, not from "centralized planning," (compare Pet. Br. at 6), but because centralization is incomplete, J.A. 119-120, since there has been neither overall production cost sharing nor joint plant construction. *See Middle South Energy, Inc.*, 30 FERC ¶ 63,030, 65,167 (1985); *Middle South Energy, Inc.*, Opinion 234-A, 32 FERC ¶ 61,425, 61,955, 61,959 (1985). Thus, the 1973 System Agreement[2] did not "equalize" the companies' power costs, but rather provided a formula for apportioning only the companies' responsibility for certain *excess* power, and the 1982 System Agreement operates similarly, with certain changes in the formula.[3] Further, the variable costs of generation are allocated first to a unit's owner, and then according to the requirements of other companies. J.A. 119; CNO Exh. 29 at 237; 32 FERC at 61,955. In recon-

[2] At NOPSI's instance, the 1973 System Agreement is reprinted in the Joint Appendix, and NOPSI cites it here directly in support of certain arguments, notwithstanding that the question before the Court is one of "facial" preemption, independent of the factual record. The *actual* practices of the MSU companies are not self-evident from the formal terms of the agreement and required separate testimony. *See* J.A. 105-122; 31 FERC at 61,645-51; 32 FERC at 61,952-955.

[3] The operation of the formula is described under "Cost Allocation Under The 1973 System Agreement" at J.A. 115-119; and changes therein in the 1982 System Agreement at J.A. 140.

sidering its initial descriptions of system costs, FERC recognized that the system agreements had achieved only "rough equalization;" did not result in the MSU companies paying an equal or proportionate basis for power; and left each company's costs based largely on its plant ownership and power contracts. 32 FERC at 61,959.[4] Over a period of 20 years, NOPSI had experienced the highest power costs in the "system"—exceeding those of AP&L, for example, by over 50%.[5] J.A. 120-122.

Thus, the planning and building of plants for the "benefit of the system as a whole" has never obviated the need for each company to determine its own specific power commitments. Under federal law, a utility "system" may not be so large as to "impair" the "advantages of localized management, efficient operation and the effectiveness of regulation."[6] The system agreements specifically placed responsibility individually on each company to "own, or have available to it under firm contract," power as is "necessary to supply all the requirements of its customers." J.A. 112-113. According to petitioner's president, "Neither the affiliation of the MSU operating companies" nor the "existence of the" [MSOC] "relieves any MSU operating company from its public utility duty to serve its load." J.A. 113. Thus, to meet their own needs for power and diversification, the MSU companies individually bought and sold power. For example, during the 1970's, AP&L built

[4] In Opinion 234-A, FERC stated, "We also recognize, although it is not emphasized in the Opinion [234], that pool members have first call on the power and energy produced by units which they own;" Opinion 234-A, 32 FERC at 61,955; and that its decision to leave the prior non-nuclear cost system intact "allows the individual companies to *retain* as fully as possible the benefits of units *they* have financed and constructed." 32 FERC at 61,959 (emphasis added).

[5] FERC's statement that earlier costs were "*roughly* equalized" tends to mask preexisting differences but reflects that they were *dwarfed* by the massive disparities threatened by the companies' allocation of Grand Gulf costs. *See Middle South Energy, Inc.*, 26 FERC ¶ 63,044, 65,110 (1984).

[6] Public Utility Holding Company Act, 15 U.S.C. §79b(a)(29).

certain coal-fired plants; it sold some off-system, and MP&L bought some, while NOPSI bypassed the opportunity. The system agreements do not hinder such transactions and, indeed, have evolved so as to facilitate them.[7] J.A. 130-132, 198-200.

FERC concluded that the MSU system was sufficiently "integrated" to justify reallocation of power among the companies, 31 FERC at 61,649-51, but FERC disclaimed any implication that it had failed to recognize the independent characteristics of the companies. 32 FERC at 61,952-53, 61,955.[8] Further, FERC never addressed the separate question of each company's responsibility to adjust its power arrangements to meet its local needs once its obligations to the "system" were met, a subject beyond the scope of its jurisdiction. *See* pp. 9-11, 37-38, *infra*.

3. Grand Gulf I and Other Generation Additions [J.A. 122-132]

Until recently, the generation plants on the system were fueled by natural gas or oil. In the late 60's, the supply

[7] ALJ Liebman's findings, endorsed by the FERC, noted that the "system goal" of greater ownership of nuclear and coal units did not imply or require a particular allocation of nuclear power to a particular MSU operating company. 26 FERC at 65,108. In its Brief on Exceptions in Docket No. ER82-616 (Mar. 5, 1984), at 48 MSE stated, "[A]lthough the system as a whole might have sufficient coal and nuclear capacity, those companies lacking access to such generation through either ownership or a unit power purchase would remain vulnerable to the uncertainties in price and availability of oil and natural gas."

[8] The premise of the FERC's analysis was that if it found the MSU system sufficiently "integrated," it could reallocate Grand Gulf 1 costs among the companies, but that if the companies were "autonomous" it would not be appropriate to do so. 31 FERC at 61,645; 32 FERC at 61,953. The FERC approached the problem notionally, without articulated benchmarks for "integration" or "autonomy," or the effects that would attend either, and it directed its determinations principally at AP&L, 26 FERC at 65,113, to undo "the scheme of absolving AP&L of all responsibility for Grand Gulf." *Mississippi Indus. v. FERC*, 808 F.2d 1525, 1533 (D.C. Cir), *vacated in part*, 822 F.2d 1104 (D.C. Cir. 1987), *cert. denied*, 484 U.S. 985 (1987).

of gas became scarce, and pipeline companies curtailed deliveries; in the early '70's, an international embargo made oil prices higher and volatile; and such events pushed the MSU companies toward other fuel alternatives. J.A. 124-125. In 1970-71, the companies' load forecasts showed the need for the additional generation capacity. J.A. 125. MSOC commissioned a study that resulted in its recommending two nuclear plants as most economic for this purpose. J.A. 125. One plant was assigned to MP&L, and the other to NOPSI to be built in New Orleans. J.A. 125-126. However, a site engineering study and the rising costs of nuclear plants caused NOPSI to terminate its nuclear effort, and MP&L undertook both projects. J.A. 126.

Because MP&L could not obtain financing, the backing of all the operating companies was enlisted. In 1974 each MSU operating company entered into the "Availability Agreement," and thus obligated itself to take and pay for an indeterminate amount of power. J.A. 127-128. Although not a necessary choice, plant ownership was placed in a new subsidiary, MSE (now "SERI"). *Id.*[9]

As Grand Gulf's construction advanced, the companies' load forecasts fell. Further, during the 1970's, the real (inflation-adjusted) costs of nuclear plants increased rapidly, due primarily to additional construction requirements,[10] including retrofits, impelled by growing safety

[9] Although the system's overall goal was to move to a 50-50 mix of nuclear and coal generation, J.A. 125, NOPSI's management made no commitment to obtain coal-fired generation and had no prospect of participating in a coal plant for at least a decade, and that prospect never materialized. Other MSU companies made individual commitments to buy or to build coal-fired generation. J.A. 125, 130-132.

[10] Petitioner's brief omits reference to the new "construction requirements" that added the principal *real* costs to nuclear plants. It also attributes cost increases only to regulatory delays and inflation and indicates that cost problems arose only after the Three Mile Island ("TMI") incident (Pet. Br. at 6-7), all of which is incorrect. *See* J.A. 133, 173. The *real* (inflation adjusted) cost of constructing nuclear plants had more than *doubled* during the 1970-1978 time period. J.A. 190. The TMI incident in March 1979 ultimately resulted in *even greater*

concerns. Such costs were augmented by regulatory delays and spiraling inflation. By the end of 1978 (four years after its initiation) the projected cost of Grand Gulf had increased over 60%. J.A. 133. Further, in March 1979, a major accident occurred at the TMI nuclear plant. Particularly because of the accident's unanticipated nature, it precipitated a national safety inquiry and prospective cost increases for nuclear plants still under construction. J.A. 135; 180-184.

The FERC never determined the point in time when the anticipated benefits of Grand Gulf power first appeared questionable. Nor did FERC indicate *when* the costs or problems of nuclear units were "unforeseen" (*compare* Pet. Br. at 7 *with* 31 FERC at 61,655). Nor did it state that the cost increases "between 1980 and 1985" were "unexpectedly dramatic," but rather it put no time frame on this observation. *Compare* Pet. Br. at 7 *with* 31 FERC at 61,654. (In contrast, FERC *did* say that *by 1979* the system appeared to have recognized that there were cost-related problems unique to nuclear units, 31 FERC at 6 ,655 n.16—an observation consistent with that of the Council's. J.A. 167.) Further, there simply was no FERC "finding" on the prudence of continued plant *construction*, *see* pp. 9, 45-46, *infra*, much less on the issue of whether it was advisable for an operating company to resell some of its power—two questions that involve materially different considerations.[11] (The Council, in turn, made *no* finding re-

safety-driven construction changes, retrofits, and cost escalations, J.A. 180-84. Petitioner's ostensible purpose is to suggest that the large cost increases were only inflation-based and that petitioner's management could not be aware of the potential for increased costs due to safety-driven construction requirements. *Compare* J.A. 171-73, 180-84.

[11] Whether to *complete* a plant depends materially upon *how far* construction has proceeded—and specifically on whether the (1) "to go" (additional) costs of construction, together with the plant's anticipated operating costs, are less than the (2) cost of terminating construction and mothballing the plant *plus* the cost of the most economical alternative source of power in the quantity needed. In contrast, the decision whether to retain all the power from a plant does not depend in the same way on the extent of completion but on whether the (1) *total*

garding continued plant construction—and it examined only whether NOPSI should have retained all the power it stood to receive. J.A. 70-72)

4. 1980 Hearings Before the Council [J.A. at 141-143]

During the construction of Grand Gulf, NOPSI's management was grossly negligent in failing to exercise oversight over NOPSI's Grand Gulf obligation. *See* J.A. 70-72, 161-171, 184-188. Further, in the wake of TMI, with the economics of Grand Gulf in question, NOPSI's management inexplicably committed in January 1980 to take a huge share of both Grand Gulf I and Grand Gulf II—about 30% of the MSE share, several times NOPSI's system load share (8.4%). J.A. 136. NOPSI's management also agreed that AP&L—a politically powerful company—need take none. This, according to petitioner's own witness, occurred when "everyone knew what the costs of the unit were going to be," CNO Exh. 33 at 856; J.A. 191, or, at least, that previously expected benefits of Grand Gulf were in question. J.A. 202. Without explanation, these acts bypassed the usual MSOC decisionmaking process. 26 FERC at 65,103. FERC found that NOPSI's management had agreed to an unreasonably large share. J.A. 198.

In May 1980, NOPSI sought the Council's approval of an unusual "capacity adjustment clause" to authorize in advance an *automatic* pass-through of NOPSI's 30% share of Grand Gulf costs, portraying its proposal as speeding "benefits" to the ratepayers. J.A. 141-42. This was the first time that NOPSI had even informed the Council of its Grand Gulf commitments. J.A. 141. Under oath, NOPSI's president twice asserted that NOPSI had the option of selling Grand Gulf power to other utilities:

> . . . NOPSI has the option of selling the capacity and marketing it which, we think will be a very attractive commodity to other electric utilities

cost of that power—*i.e.*, sunk costs *and* "to go" costs—plus operating costs, is less than (2) the cost of the most economical alternative power in the quantity needed. The calculations in each instance are different. So are the business considerations. See pp. 44-45, *infra*.

> who will view this as very cheap, reliable power for the future.

J.A. at 143; and again, "[W]e will have the option of selling this unit and our portion of it to some other buyer." *Id.* The Council declined to approve the automatic adjustment clause but took no other regulatory action. J.A. 203.

5. The FERC Proceedings [J.A. at 143-49]

In 1982, MSE commenced proceedings at FERC to seek approval of the companies' Grand Gulf agreements and related matters. At issue was the *allocation* of Grand Gulf costs by formula "among the four MSU operating companies" that sponsored the plant. 31 FERC at 61,632. One proceeding involved the Unit Power Sales Agreement, which set the fixed shares to which the companies had just agreed. Docket No. ER82-616. The other involved the 1982 System Agreement that governs certain aspects of the planning of generation and transmission facilities and the allocation of excess generation. Docket No. ER82-483.

No prudence issues—not even those investing in, constructing or completing Grand Gulf—were raised.[12] ALJ Liebman made clear that he would not venture into matters regarding the responsibilities of, or prudence of, the individual operating companies, twice stating, "I'm not getting into that," J.A. 101, and refused to be drawn into the preclusion of state-level prudence reviews. *Id.*

FERC issued one order, Opinion No. 234 (affirmed in Opinion No. 234-A), for both cases, rejecting the agreed upon allocations. 31 FERC at 61,655. It found that power planning was highly coordinated, that plants were built for the system as a whole, and that Grand Gulf had been planned for all companies from the outset—findings providing a basis for reallocation. 31 FERC at 61,632-33. (*See* n.8 *supra*.) It determined that the costs of all nuclear plants should be shared because of their unique problems;

[12] It bears emphasis that the order "defining and limiting" the issues to be considered to fifteen specified matters did not include any "prudence" issue among them. 26 FERC at 65,096-65,097.

and that other generation costs should not be shared so as "to allow the individual companies to retain the benefits of units which they have been responsible for constructing." 32 FERC at 61,955. It adopted a formula for the allocation of Grand Gulf costs that allowed each company to retain the benefits of any nuclear plant it had constructed, *viz*: (1) each company's share of total system nuclear investment was established; and (2) any "shortfall" between that share and the company's actual nuclear investment was made up by a share of Grand Gulf I. 31 FERC at 61,655. It reduced NOPSI's 29.8% share to 17%, and it allocated a share to AP&L. *Id.*

Wholesale rates followed from the application of that formula. FERC declined to determine how such costs should be recovered in retail rates. It declined even to address a phase-in ("levelization") of such rates that would have impact at the retail level, lest the "bright line" of its jurisdiction be crossed, 26 FERC at 65,148; and it did not order states to refrain from retail inquiries.[13] Instead, FERC noted its limited jurisdiction, acknowledged the traditional role of the states in retail matters, 32 FERC at 61,951-52, and concluded that "[t]he basic nature of regulatory control retained by the states under previous System agreements remains unchanged." *Id.* at 61,952.

FERC confirmed in Congressional testimony that the responsibilities of the operating companies were not a subject for consideration because no rate had been filed in which such companies tried to pass on *their* costs:

> The proceeding was not one in which the operating utilities attempted to pass through the actual costs associated with the Grand Gulf plant as purchased power expenses in rates charged to their customers.

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[13] *Middle South Energy, Inc. and New Orleans Pub. Serv. Inc. v. City of New Orleans*, No. 85-5273, slip op. at 7, (E.D. La. Dec. 19, 1986), *aff'd, New Orleans Pub. Serv. Inc. v. City of New Orleans*, 833 F.2d 583 (5th Cir. 1987). ("*NOPSI II*")

and that,

> [T]he Commission has taken the position that the prudence of a party as the *purchaser* in an individual unit sale transaction is not generally within the scope of the issues considered in reviewing the rates and terms for the jurisdictional *sale* of power.[14]

6. CNO's Position and the Judicial Review of the FERC's Order

Petitioner misportrays, in conflict with FERC's own recitals, New Orleans' position in FERC and subsequent review proceedings so as to imply that FERC had made determinations inconsistent with those in the prudence hearings. New Orleans argued successfully against the agreed-upon allocations, *see* 26 FERC at 65,105. It also argued that any *inter*company reallocation should be limited to Grand Gulf and should be based on each company's "responsibility ratio" because (1) the initial justification for Grand Gulf had been to meet projected load growth; and (2) certain FERC precedent supported that allocation method. 26 FERC at 65,112-113. FERC answered that (1) the justification for Grand Gulf had changed to fuel diversification; and (2) the precedents involved all system plants, rather than one. *Id.* New Orleans then argued that any reallocation extending beyond Grand Gulf should encompass *all* plants on the system. 31 FERC at 61,642. FERC responded that although all plants had been built "for the system" only the nuclear plant costs should be reallocated since they were larger. 31 FERC at 61,655. The Court of Appeals rejected[15] FERC's determination on

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[14] *Powerplant Costs: Hearing Before the Subcomm. on Energy Conservation and Power of the House Comm. on Energy and Commerce*, 99th Cong., 2d Sess. 29, 21 (1986) (Statement of FERC Acting Chairman) (emphasis in original).

[15] On appeal, the FERC's decision was remanded for reconsideration. *See Mississippi Indus. v. FERC*, 822 F.2d 1104, 1105 (D.C. Cir. 1987), *cert. denied*, 484 U.S. 985 (1987). On November 30, 1987, the FERC issued Opinion No. 292 in which it confirmed its prior allocation, *System*

the strength of Judge Bork's opinion (1) challenging the rationale of FERC noted above; and (2) noting that FERC's own decision had resulted in significant cost disparities. *Mississippi Indus.*, 808 F.2d at 1569 (Bork, J. dissenting), *adopted on rehearing*, 822 F.2d 1104 (D.C. Cir. 1987).

On remand, FERC held that its allocation scheme was equitable if its goal of equalizing nuclear investment costs were tested by demand, rather than by capacity, 41 FERC at 61,617, and defended its singular focus on nuclear plants because of their costs. *Id.* at 61,620. New Orleans' arguments there relied upon basic allocation principles, *viz*: (1) similar rates for similarly treated customers; (2) preservation of cost equalization; and (3) matching costs and benefits, and were so characterized by FERC. *Id.* at 61,621. The FERC's decision to maintain its prior allocation decision had virtually nothing to do with the issues involved in the subsequent prudence inquiry.[16]

7. NOPSI's Rate Application and the Filing of *"NOPSI I"* [J.A. at 150-154]

On May 17, 1985 (two days after the Council reacquired regulatory authority from the LPSC[17]), NOPSI applied for a retail rate increase to reflect its Grand Gulf costs as set by the FERC. Grand Gulf had been placed in service at

Energy Resources, Inc., 41 FERC ¶ 61,238 (1987), which was upheld. *City of New Orleans v. FERC*, 875 F.2d 903 (D.C. Cir. 1989), *cert. denied*, 110 S.Ct. 1305 (1990).

[16] Petitioner seems to imply that the issue of NOPSI's not having coal power was resolved by FERC, Pet. Br. at 10 n.12. However, the issue FERC addressed was whether NOPSI's lack of coal-fired power should be a factor in establishing the formula by which the *relative* intercompany shares of nuclear power should be *allocated* (*i.e.*, full production cost equalization would have equalized non-nuclear costs), *not* whether NOPSI (having accepted its allocated share) could take its own lack of coal power into consideration in determining how to diversify.

[17] The Council exercised electric utility regulatory authority from 1922 to November 23, 1981. Pursuant to a referendum, it was then transferred to the Louisiana Public Service Commission ("LPSC") until another referendum returned such authority to the Council in May 1985. J.A. 64 n.1.

a "catastrophically uneconomical" cost,[18] exceeding $3.6 billion, six times its original projection. If passed through fully and immediately, NOPSI's share would have resulted in a 60% rate increase. J.A. 67-68. The ensuing "severe rate shock effect"[19] would have been devastating.[20]

At first NOPSI made a proposal to moderate the rate increase through a "phase-in", but withdrew it when the Council undertook to hold formal hearings. The Council promptly established procedural and filing requirements, which NOPSI sought to avoid. J.A. 151. NOPSI filed a late, partial application. *Id.* at 152. The Council volunteered to *initiate* proceedings to grant NOPSI an interim rate increase and took steps to facilitate any NOPSI application. *Id.* NOPSI *refused* to apply for interim relief, *id.* instead it commenced its first federal suit, *"NOPSI I"* (n.19 *supra*), the purpose of which was (1) to intimidate the Council's members by suing them personally for $1 billion; and (2) to require that Grand Gulf costs be passed through immediately without moderation. *NOPSI I*, Complaint, pars. 53 and 56. The district court found that the Council was acting responsibly[21] and directed NOPSI to apply for the interim rate relief. The Council then granted

[18] *Mississippi Indus.*, 808 F.2d at 1528.

[19] *New Orleans Pub. Serv. Inc. v. City of New Orleans*, No. 85-3398, slip op. at 5 (E.D. La. Sept. 16, 1985), *aff'd*, 798 F.2d 858 (5th Cir. 1986), *modifying* 782 F.2d 1236, (5th Cir.), *cert. denied*, 481 U.S. 1023 (1987) (*"NOPSI I"*).

[20] The unmitigated pass-through of NOPSI's Grand Gulf I costs would have caused the loss of over 6,000 jobs, pushed 1,760 families below the poverty line, reduced state and local tax revenues by over $30 million annually, and had a profound adverse effect on the community's economy. *See* J.A. 68 n.2. There was apprehension as to the potential "death spiral" effect of "rate shock," triggered by passing on unpaid costs to an ever-diminishing base of paying customers.

[21] The district court held that the Council "is utilizing every feasible alternative to keep NOPSI in a positive cash position", and further, that "the Council is determined to assist NOPSI in maintaining a positive cash position by pursuing a number of feasible alternatives." *NOPSI I*, slip op. at 11-12.

such relief and offered more if needed. J.A. 152; Res. R-85-526. The district court abstained and was affirmed (*see* n.19 *supra*).

Promptly upon NOPSI's submission of its application, on October 10, 1985 the Council commenced a prudence inquiry[22] with the objective, as summarized by this Court, to:

> [E]xamine all aspects of NOPSI's relationship with Grand Gulf, including NOPSI's " 'efforts to minimize its total cost exposure for the purchase,' " and Grand Gulf's " 'impact on its other power supply opportunities,' " " 'for the purpose of determining what portion, if any, of NOPSI's Grand Gulf I expense shall be assumed by [NOPSI's] shareholders.' " . . . The resolution specifically provided, however, that in setting the appropriate retail rate, the Council would " 'not seek to invalidate any of the agreements surrounding Grand Gulf I or to order NOPSI to pay MSE a rate other than that approved by the FERC.' "

New Orleans Pub. Serv. Inc. v. Council City of New Orleans, 491 U.S. 350, 356 (1989) (*"NOPSI III"*) (quoting J.A. 153).

NOPSI and MSE filed a second federal action, *NOPSI II*, in November 1985 seeking to bar any prudence inquiry, later narrowing their complaint to seek to preclude any remedy reducing rates. The suit was dismissed on abstention and ripeness grounds in December 1986; and that dismissal was affirmed on ripeness grounds (*see* n.13 *supra*).

The prudence inquiry did not prevent a Grand Gulf rate increase, which was effected through a partial settlement on March 22, 1986. J.A. 67. It provided, *inter alia*, that

[22] A "prudence inquiry" reviews the actions of a utility's management to determine whether it comported with established standards of care at the time in question. See *"The Purpose of and the Standards Governing This Prudence Investigation,"* J.A. 88-97.

NOPSI would receive phased-in increases and would absorb $51.2 million in costs. (All other MSU operating companies had already reached settlements involving phase-ins; and the two largest, LP&L and AP&L, undertook major cost absorptions. J.A. 98 n.31.) The settlement preserved the right to conduct the prudence inquiry, subject to judicial review. J.A. 218-219.[23]

8. The Prudence Inquiry

The prudence inquiry was conducted in three parts. The first, dealing with substantive prudence issues concluded with evidentiary hearings in April 1986. J.A. 68-69. Proceedings regarding the economic impact of possible remedies were held in October 1986. *Id.* at 69. The passage of tax legislation required a third phase for reconsideration of economic issues. *Id.* The Hearing Examiner certified the entire record to the Council on April 16, 1987. *Id.* NOPSI blocked the Council's inquiry into the role of the "system," and insisted that the Council accept some testimony without any opportunity for examination. J.A. 78-88.

The Rate Order issued on February 4, 1988, did not purport to alter the FERC's cost allocation to petitioner or assume a different allocation for the establishment of retail rates, but focused on possible offsets to such costs. J.A. 70-72; 201. The Council took care to conform its proceedings to the law. J.A. 97-105. It found NOPSI's management imprudent based on vivid and overwhelming evidence of neglect and inaction, J.A. 161-170, and for its

[23] Petitioner recites that "to obtain interim relief and avoid insolvency," NOPSI agreed to a settlement. (Pet. Br. at 13 n.18.) This is contrary to the record. In fact, (1) the Council had previously provided interim relief to a recalcitrant NOPSI; (2) the district court found that NOPSI was solvent and that the Council was acting in good faith to maintain NOPSI's position; (3) all the other MSU companies, as indicated, had already reached settlements; (4) NOPSI itself proposed the settlement and did so during a period when it appeared to have won its federal appeal; and (5) its president publicly complimented the Council on its acceptance of the settlement (Tr., Mar. 20,1986 at 7-8, Council No. CD 985-1).

consequent failure to pursue the very risk-reduction measures (offsetting power sales) that NOPSI's management stated it could make consistently with its Grand Gulf obligations. J.A. 142-143; 197-203. The Council "deferred to FERC's" findings but determined that "the utility's management was negligent in failing later to diversify its supply portfolio by selling a portion of its Grand Gulf power." *NOPSI III*, 491 U.S. at 352-53.

The Council determined that the evidence supported a rate disallowance based on a full 17% disposition by petitioner of its share or a disposition reflecting a retention of 9% of it, but, instead it imposed a disallowance of about 3% or $135 million[24]—set to a level that NOPSI could "sustain." J.A. 72-73; 210-212; 242-243. That is, it would permit petitioner (1) to meet its Grand Gulf obligations, (2) maintain its operations, and (3) return to financial health, and it was imposed gradually as a reduction of rate increases over several years. J.A. 242-244.

Although at least 57 utilities were identified as potential customers for nuclear power, J.A. 201, and despite serious doubts raised about its management's inaction, petitioner made no serious effort to contest the availability of buyers in the 1979-80 timeframe. *Id.* at 203. Petitioner asserts that the Council never identified a particular buyer for NOPSI's nuclear power, but it was not the Council's obligation to do so, J.A. 94-97, and petitioner is aware that

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[24] Petitioner's assertion that the Rate Order was based on a finding that would have reduced NOPSI's costs "by the precise amounts that the City" had proposed to FERC (Pet. Br. at 3) is just inaccurate. The 3% reduction is far less than what would have resulted from New Orleans' position at FERC. Petitioner's erroneous statements in this regard were the apparent basis for an error in the original Fifth Circuit opinion below, which was corrected by that Court without objection by petitioner. J.A. 16. Even *if* the Council had held that NOPSI should have sold off an amount that would yield retained power exactly equal to the 8.4% that New Orleans sponsored at FERC, the resulting costs would not have been the same, inasmuch as in one case the remainder would have been priced at coal rates and in the other at "excess" power rates under the system agreement.

there was a major buyer nearby in the very period in question, and potentially many more, but skirted the issue in the evidentiary hearings.[25] There was direct evidence that petitioner's Grand Gulf power was marketable in 1979-1980. J.A. 201; *Alliance for Affordable Energy*, 578 So. 2d 949, 962-64 (La. Ct. App. 1991).

9. This Action and Related State Court Proceedings

Given petitioner's determination to bypass the usual state court review process, the Council promptly commenced an action in Louisiana Civil District Court seeking, *inter alia*, judicial review of the Rate Order,[26] as did a citizens' group, intervenor here.[27] NOPSI then commenced the present action to enjoin the Rate Order on preemption grounds, and it filed a state court action.[28] After the federal district court abstained, *NOPSI v. Council of New Orleans*, No. 88-559, slip op. (E.D. La. Mar. 10, 1988), NOPSI added federal claims to its state action and sought a preliminary injunction.

That application was denied, and the denial affirmed for lack of irreparable harm.[29] The matter was returned to

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[25] In August 1979, another Louisiana utility, Cajun Electric Cooperative, whose electric lines are connected to the MSU transmission system, contracted to purchase a 30% share of the River Bend nuclear plant. See *Gulf States Utilities Co. v. LPSC*, 578 So. 2d 71, 76 (La. 1991).

[26] *Boissiere v. New Orleans Pub. Serv. Inc.*, No. 88-2503 (La. Civ. Dist. Ct. filed Feb. 4, 1988).

[27] *Alliance for Affordable Energy, Inc. v. Council of New Orleans*, No. 88-2502 (La. Civ. Dist. Ct. filed Feb. 4, 1988).

[28] *New Orleans Pub. Serv. v. City of New Orleans*, No. 88-4511 (La. Civ. Dist. Ct. filed Mar. 7, 1988). Petitioner's complaint alleged that the Rate Order was arbitrary, capricious and not supported by substantial evidence; applied an erroneous standard of prudence; breached the March 1986 settlement agreement; violated NOPSI's Louisiana due process rights; and constituted an unlawful "taking.

[29] *New Orleans Pub. Serv. Inc. v. City of New Orleans*, No. 88-4511 (Civ. Dist. Ct. May 5, 1988), *aff'd*, No. 88-CA-1369 (La. Ct. App. Feb. 16, 1989).

state trial court to be heard on the merits. After a delay to await this Court's determination in *NOPSI III* (decided June 19, 1989) and an extended period thereafter for reargument and to hear other issues, the Louisiana court ruled on November 15, 1989 that the Rate Order was not facially preempted and that "each of the findings in the Council's Rate Order is rationally based and is supported by substantial evidence in the record." *NOPSI v. Council of New Orleans*, No. 88-4511, slip op. at 6.

Before that ruling, in September 1989, the Council had moved in federal district court for a stay on the basis of the more advanced state court proceedings. NOPSI moved for summary judgment based on facts which the Council disputed. J.A. 280-325. The court ordered that the prudence evidentiary record be filed (No. 88-559, Minute Entry at 1, Sept. 14, 1989), and it heard argument on October 25, 1989, declined to stay, and took the case *sub judice*.

After the state court rendered its decision on the merits, the Council filed the certified state judgment in federal court and moved to dismiss or alternatively to stay. The federal district court's order, finding no "facial" preemption and staying remaining proceedings, was issued on January 3, 1990. It was affirmed. J.A. 11-33.

The Louisiana Court of Appeals for the Fourth Circuit affirmed the state decision on April 4, 1991 finding *inter alia*, that (1) the Council's factual findings were supported not merely by "substantial" evidence but by a "preponderance"; (2) its order was not facially preempted; and (3) there were no due process, commerce clause or related violations; but that (4) the Council erred in moderating the remedy, so that the disallowance should be increased. *Alliance for Affordable Energy*. Within days, however, the Louisiana Supreme Court declared that a regulator could moderate a remedy as the Council did.[30] Review by that court has been sought and on July 19, 1991 it agreed to

[30] *Gulf States Utilities Co. v. LPSC*, 578 So. 2d 71 (La. 1991).

expedite its consideration of the petitions for review pending there.

SUMMARY OF ARGUMENT

Here, FERC allocated the power and cost of Grand Gulf *among* the individual operating companies, establishing their *relative* shares. It made no findings as to prudence and disclaimed authority to consider the responsibilities of the buying companies. In contrast, the Council accepted the FERC's cost allocation for purposes of retail rates, addressed the responsibility of petitioner, and found its management negligent in failing to sell off some nuclear power petitioner stood to receive, as it said it could, and thus bypassed cost savings. It left the company's relative share and the FERC's determinations unaffected. In *NOPSI III*, this Court observed that these circumstances "hardly" demonstrated manifest "facial" preemption; that, "Nothing in this is directly or even indirectly foreclosed" by federal law and that "further factual injury" was required. 491 U.S. at 367. Because there has been no further *factual* inquiry in federal court,[31] and because *NOPSI III* recognized a legitimate basis for a disallowance if *factually* supported, there is no "facial" preemption here.

Indeed, since the issue was, in the interim, decided by a Louisiana state court under a statutory regime that made that decision "conclusive" of all similar actions between the parties and required their dismissal, La. Code Civ. Proc. Ann., art. 531, the district court was bound to give preclusive effect to that decision under 28 U.S.C. § 1738, and should have dismissed the case.

The legislative history of the Federal Power Act ("FPA") shows clearly that Congress was intent upon defending state utility regulation against just the type of expansionist arguments made by the opposing parties here. It embodied in the FPA itself that FERC jurisdiction can-

[31] A review of the factual evidence in state court found the Council's determinations to be well supported. *See* p. 18, *supra*.

not extend to any matter "subject to regulation by the state," 16 U.S.C. § 824(a). The responsibility of a retail operating company with respect to power options that *are* available to it *is* clearly "subject to regulation by the state." Indeed, the FERC has declared in this *very* case and elsewhere, that it is not within FERC's jurisdictional responsibility to make such determinations, and it has *invariably* declined to do so.

There was no way that the Council could have raised the issue of petitioner's inaction at FERC, and the contention that the Council "withheld" an argument to raise it later is ludicrous. FERC could consider such a matter only in a proceeding in which a *wholesale* customer of petitioner challenged petitioner's failure to sell power, as part of FERC review of the rate that petitioner sought to charge such customer. There is not a case in FERC history in which FERC has acted otherwise. If the Council could not exercise oversight of NOPSI's management regarding its failure to explore resale opportunities, serious acts of mismanagement detailed in the factual record here, and confirmed in the state court review, would simply escape scrutiny.

The opposing parties' contention that once FERC allocates costs as "just, reasonable and nondiscretionary" they *must* be reflected without setoff in retail rates is based on the fallacy that, in the real world, FERC-allocated power, even if uneconomic, must be retained. Under such a position, even if the operating company had sold the power, the results, profitable or lossbearing, could not be reflected in retail rates; and even if the facts clearly show that the company should have sold but failed to do so, no account could be taken of it.

FERC's jurisdiction, even with respect to companies that are part of a multistate "system", has been limited to matters of *inter*company consequence—the decision to participate in a project designed for multiparty benefit; to construct and to complete it; and the *relative* allocations

of it among the companies. The decisions in *MP&L*[32] and *Nantahala*[33] are completely consistent with the Council's exercise of its jurisdiction.

Finally, there are not even any *factual* inconsistencies in the respective determinations of FERC and the Council, and in particular, FERC made no findings on "foreseeability," prudence, or other significant matters that are at odds with those of the Council. Even if there were *factual* inconsistencies, they would have to be dealt with, but they form no basis for *facial* preemption.

ARGUMENT

I. *NOPSI III* Left Virtually No Room For A "Facial" Disposition Of The Case; Moreover, It Did Not Anticipate That There Would Be Further Fractionated Consideration Of The Matter

A. The Decision In *NOPSI III*

Although the instant review concerns the same proceeding addressed in *NOPSI III*, the opposing parties advance their arguments by submerging the opinion's critical language. See Pet. Br. at 16, 35-36; S.G. Br. at 26. In NOPSI III the facial preemption claim was the very cornerstone of the opposing parties' abstention argument.[34] In response, this Court first described its holdings in *Nantahala* and in *MP&L*—much more narrowly than do the opposing briefs here, 491 U.S. at 352—and then distinguished the instant case:

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[32] *Mississippi Power & Light v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988).

[33] *Nantahala Power & Light Co. v. Thornberg*, 476 U.S. 953 (1986).

[34] Petitioner posed its "Question Presented" as whether abstention was appropriate where the FPA and FERC's "explicit orders" had "preempted local regulatory authorities from making . . . determinations of the very matters FERC has decided." (Pet. Br. at i, *NOPSI III*, No. 88-348.) The government posed the question similarly, as whether abstention was appropriate as to a claim that the local regulator "is violating federal law by refusing to honor terms fixed by" the FERC. (U.S. Br. at I, *NOPSI III*, 88-348.)

> Here the state ratemaking authority deferred to FERC's implicit finding that New Orleans Public Service, Inc.'s decision to participate in the Grand Gulf venture was reasonable, but determined that the costs incurred thereby should not be completely reimbursed because, it asserted, the utility's management was negligent in failing later to diversify its supply portfolio by selling a portion of its Grand Gulf power.

491 U.S. at 352-53.

The Court found abstention inappropriate under *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943), principally because "NOPSI's primary claim" that the Council "is prohibited by federal law from refusing to provide reimbursement for FERC-allocated wholesale costs" did not significantly involve state law matters.[35] Concurrently, the Court held that NOPSI's so-called "pretext" claim[36] could not be resolved on the face of the Rate Order because it turned on factual evidence. 491 U.S. at 363.

Turning next to the contention that *Younger v. Harris*, 401 U.S. 37 (1971), did not require abstention because petitioner's preemption claim was "facially conclusive" as the Rate Order was "on [its] face plainly invalid" and "flagrantly and patently" in violation of FERC's order and federal law, 491 U.S. at 367, the Court responded that such a circumstance was "hardly" present here:

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[35] "[N]o inquiry beyond the four corners of the Council's retail rate order is needed to determine whether it is facially pre-empted by FERC's allocative decree and relevant provisions of the Federal Power Act." 491 U.S. at 363.

[36] In *NOPSI III*, the Court believed that "in its initial complaint, NOPSI had asserted, as an alternative," that the Rate Order's "emphasis" on NOPSI's failure to diversify was merely a "cover for the determination that the original Grand Gulf investment was itself unwise." 491 U.S. at 393. However, NOPSI filed only one complaint, and it asserted no such claim. Rather, what petitioner now calls its "pretext" claim first appeared in a footnote in its Reply Brief here in *NOPSI III*. Petitioner later conceded that the claim had not appeared in its complaint. Tr. at 13-14, Oct. 25, 1989, No.88-559 (E.D. La.) (*see* J.A. 27).

> The Council has *not* sought directly to regulate interstate wholesale rates; *nor* has it questioned the validity of the FERC-prescribed allocation of power within the Grand Gulf system, or the FERC-prescribed wholesale rates; *nor* has it reexamined the prudence of NOPSI's agreement to participate in Grand Gulf 1 in the first place. *Rather*, the Council maintains that it has examined the prudence of NOPSI's failure, after the risks of nuclear power became apparent, to diversify its supply portfolio, and that finding that failure negligent, it has taken the *normal ratemaking step* of making NOPSI's shareholders rather than the ratepayers bear the consequences. *Nothing in this is directly or even indirectly foreclosed by the federal statute, the regulations implementing it, or the case law applying it.*

Continuing, the Court indicated that resolution of the preemption issue in this case was dependent upon further *factual* inquiry:

> There may well be reason to doubt the Council's necessary *factual* finding that NOPSI would have saved money had it diversified. See n. 2, *supra*. But we cannot conclusively say it is wrong *without further factual inquiry*—and what *requires further factual inquiry* can hardly be deemed "flagrantly" unlawful for purposes of a threshold abstention determination.

Id. (emphasis added). The Court did not suggest that there was a "facial" ground on which a finding of preemption might rest, short of examining the factual underpinnings of the Rate Order.[37]

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[37] In *NOPSI III* petitioner presented itemized lists of supposed conflicts of fact and conclusions between the FERC and the Council. (*Pet. Br., NOPSI III*, at pp. 10-12 nn.13, 16, 18.) They are virtually identical to those raised here. (*See* Pet. Br. at 37-43.)

Were the Rate Order "facially" preempted, there would be no set of facts given which the Council could find that petitioner's management had acted negligently in bypassing opportunities for off-system sales. Thus, the "facial" argument just cannot be squared with the availability of a legitimate factual basis for a disallowance specifically recognized in *NOPSI III*. Petitioner would seek an escape by suggesting that "only this Court can know what it meant in this passage" (Pet. Br. at 36). However, eight judges, state and federal, have found its meaning neither occult nor different from their independent analyses, all agreeing that there is no "facial" preemption and that this case must be determined by the underlying evidence.[38]

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[38] The Louisiana Civil District Court concluded:

> Here, the Council did not question the FERC allocation, did not question the purchase of Grand Gulf power, and did not question the interstate rate set by FERC. Instead, the Council found that NOPSI could have accepted the allocation, whatever it might be, and, nevertheless, could have achieved off-setting cost savings through off-system sales, as its president said it could.

NOPSI v. Council of the City of New Orleans, Civ. Dist. Ct. for Parish of Orleans, No. 88-4511 (Nov. 15, 1989), slip op. at 5-6. In affirming, the Louisiana Court of Appeals for the Fourth Circuit concluded, in part,

> NOPSI could accept the FERC allocations and still sell Grand Gulf power off system. NOPSI is able to pay its FERC-mandated costs under the Council rate order. . . . We find no conflict between the two orders . . . .

Alliance for Affordable Energy, Inc. v. Council of New Orleans, 578 So. 2d 949, 965 (La. Ct. App. 1991).

The federal district court determined that,

> The Council's decision did not question the validity of FERC's allocative decree, and the Council did not attempt to regulate interstate utility rates. Instead, the Council's inquiry focused solely upon whether NOPSI prudently managed its participation in Grand Gulf. Accordingly, this court concurs with the Louisiana Civil District Court by holding that the Council's Rate Order is not facially preempted by FERC's allocative decree.

NOPSI v. Council of the City of New Orleans, No. 88-559, E.D. La. Jan. 4, 1990, slip op. at 2-3, 8.

In affirming, the Fifth Circuit stated, in part,

> [The Court] said that nothing in the Council's order was directly or even indirectly foreclosed by prior preemption decisions. *NOPSI III*, 109 S.Ct. at 2517. Indeed, this seems analogous to the exception the Court called "perfectly sensible" in *Nantahala*, 476 U.S. at 968, 106 S.Ct. at 2357 . . . . If states may deny pass throughs because costs have gone down in other areas, it seems logical that they should be able to deny them because costs would have gone down if the utility had not been imprudent. We therefore hold the order is not facially preempted.

J.A. 26.

[39] The following colloquy with the government at oral argument of *NOPSI III* anticipated the current situation:

> QUESTION: [W]hat if the state court beats the federal court to the issue?
>
> COUNSEL: If the state court beat the federal court to the issue, then we might have a *res judicata* problem . . . .
>
> QUESTION: A rather severe one, wouldn't we?

Transcript of Oral Argument, No. 88-348, Apr. 25, 1989 at 24-25.

B. The District Court Should Not Have Proceeded To A Fractionated Disposition, In Light Of The Prior State Court Judgment

NOPSI III clearly anticipated that, upon remand, the district court would review the Rate Order's evidentiary support and determine both factual and facial preemption issues. However, the intervening decision on the merits by a state court of equally competent jurisdiction that embraced both the facial and factual claims (p. 18, *supra*), made it inappropriate for the federal court to go forward. The district court should have dismissed or stayed the action entirely, and not redecided the "facial" preemption issue.[39]

In *NOPSI III*, the Court noted that Congress principally defines the scope of federal jurisdiction, 491 U.S. at 359, and that the Council did not dispute the district court's

jurisdiction to proceed. *Id.* at 358. Here, in contrast, Section 1738 of Title 28 U.S.C. curtails the district court's right to proceed by requiring it to give the state judgment the "same full faith and credit" as it has "by law" in the state where it originated.

The "credit" due a Louisiana trial court judgment, whether or not on appeal, is that it is "conclusive of" all suits pending between the same parties on the same cause of action and requires their dismissal. La. Code Civ. Proc. Ann. art. 531.[40] Instead, the district court stayed proceedings after deciding the "facial" issue consistently with the state judgment. The Court of Appeals affirmed, but held that there was no Section 1738 bar because, it said, the trial court judgment was not "entitled to *res judicata* effect" under state law. J.A. 32.

The provision to which it referred, La. Civ. Code Ann. art. 3556(31) (West 1953), was a definitional provision that described "thing adjudged" as requiring the exhaustion or bypass of appeals,[41] but it did not answer the pertinent

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[40] When two or more suits are pending in a Louisiana court or courts on the same cause of action, between the same parties in the same capacities, and having the same object . . . . *the first final judgment rendered shall be conclusive of all.*

La. Code Civ. Proc. Ann. art. 531 (emphasis added) (see Appendix); *see Ramshur v. Allstate Insurance Co.*, 288 So. 2d 428 (La. Ct. App. 1973), *rev'd on other grounds, sub nom. Sauce v. Bustell*, 298 So. 2d 832 (La. 1974). A "final judgment" is one "that determines the merits in whole or in part" (La. Code Civ. Proc. Ann. art. 1841).

[41] In Louisiana case law, Article 3556 (31) was often cited for the proposition that a trial court judgment is not *res judicata* unless the appeal process is concluded—but such statements appear *only* in cases where the appeal process *was* concluded and a second action was barred. *See e.g., Ward v. Pennington*, 523 So. 2d 1286, 1290 (La. 1988); *Hospital Corp. of Am. v. Robinson*, 506 So. 2d 938 (La. Ct. App. 1987). Respondent is unaware of a Louisiana case within 50 years that has allowed a second identical cause of action to continue in the face of a prior trial court judgment.

inquiry here. Section 1738 does not require that a state judgment be "*res judicata*," but rather that it receive the same "credit" due in the originating state—here, that it is "*conclusive*" of all similar actions and requires their dismissal. Such effect was explicitly confirmed by the legislative report accompanying a recent change in the Louisiana Civil Code.[42] Thus, in accord with the majority rule, C. Wright, A. Miller & G. Cooper, 18 Federal Practice & Procedure, § 4433 at 308 (1981), Louisiana would not have permitted a second action to continue.[43]

There are further reasons for the district court to have curtailed the action entirely. Its fractionated decision unnecessarily perpetuates duplicative appellate tracks. It allows petitioner to claim that this Court *must* review the "facial" preemption issue now—piecemeal and divorced from the factual preemption issue—because, it asserts, the

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[42] A new statute, Louisiana R.S. 13:4231, became effective January 1, 1991. It provides, *inter alia*, that "a valid and final judgment is conclusive between the same parties, except on appeal or other direct review." The official comment makes clear that the *prior* law gave *preclusive* effect to a trial court judgment:

> The use of the phrase "final judgment" also means that the *preclusive* effect of a judgment attaches once a final judgment has been signed by the *trial* court and would bar any action filed thereafter unless the judgment is reversed on appeal. . . . [This] *is in accord with our present law* on lis pendens, see Code of Civil Procedure Articles 531, 532 (emphasis added).

La. R.S. Ann. 13:4231, Comment (d) (West 1991 Supp.) (emphasis added).

Below, NOPSI erroneously contended that this case was governed by La. Code Civ. Proc. Ann. art. 532, which applies only when a prior *federal* action requires the *state* to stay its hand.

[43] Even where state law does *not* give preclusive effect to a trial court judgment, the lower appellate courts have held that it is inappropriate to proceed and that any question, should be resolved in favor of curtailing conflicting proceedings. *See e.g., Ollie v. Riggin*, 848 F.2d 1016, 1017-18 (9th Cir. 1988); *Bailey v. Ness*, 733 F.2d 279, 282-83 (3d Cir. 1984); *Giulini v. Blessing*, 654 F.2d 189, 194 (2d Cir. 1981); *Glen Oaks Utilities Inc. v. City of Houston*, 280 F.2d 330, 334 (5th Cir. 1960); *Ray v. Hasley*, 214 F.2d 366, 368 (5th Cir. 1954).

federal judgment acts as *res judicata* on the *facial* issue in the state appeal process.[44] Thus, the decisions below interfere with the appellate process in the state courts. It is anomalous that a subsequent judgment in any second court should be urged as interdicting the orderly appellate review of the first. Further, if there were even a chance that this Court would find no "facial" bar, then the decision below raises the prospect of yet another review for *factual* preemption. This result is especially inappropriate because "facial" and "factual" preemption are not concepts so segregable that each should travel a separate track. *See* Transcript of Oral Argument, *NOPSI III*, No. 88-348 at 13-14, 32-33.

Both facial and factual issues are, however, being addressed in the state appellate process,[45] and review of *both* issues by this Court will shortly be possible.[46]

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[44] Notably, NOPSI did not claim that the federal *district* court's decision on facial preemption had a *res judicata* effect in the state proceeding, and so it briefed its "facial" position in its state court appeal. After the Fifth Circuit ruled against NOPSI, and review by this Court was contemplated, NOPSI abandoned the facial issue in oral argument before the Louisiana Court of Appeals. That court decided the facial issue independently and also ruled that it had been determined in federal court. *Alliance for Affordable Energy*, 578 So. 2d at 965-66. Petitioner now raises this reverse *res judicata* argument as a basis for this Court's acting. Pet. Br. at 20 and n.23.

[45] To date, petitioner has succeeded in frustrating the intent of Congress manifested in the Johnson Act, 28 U.S.C. § 1342, that federal constitutional challenges to state utility regulatory orders proceed only through the state courts to this Court, *viz*:

> [A utility] will be required . . . to proceed before that commission if it has any complaint. It can appeal from this State board to the State courts; and if it is dissatisfied . . . it can take an appeal to the Supreme Court of the United States. . . . It is fair to all parties concerned. It would save a large amount of time and money.

78 Cong. Rec. 2038 (1934) (Report of the Senate Judiciary Committee).

[46] There is *no* urgency whatever in this matter. NOPSI has been operating satisfactorily for years under the current rate schedule, and its current financial statements indicate that it will continue to do so. Form 10-Q, May 13, 1991, at 67 (filed for petitioner and its affiliates)—just as the Council's factual determinations anticipated. J.A. 242-243.

II. The Council Acted Properly On A Matter Within Its Lawful Jurisdiction, And The FERC May Not Expand Its Authority To Encroach Upon That Jurisdiction

A. The Legislative History Of The Federal Power Act Explicitly Contradicts Petitioner's Position

Omitted entirely from the government's brief and misportrayed in petitioner's, the legislative history is clear that Congress enacted the FPA to address only a "regulatory gap" while taking care to *protect* state regulatory jurisdiction from federal encroachment—without any purpose to address "uncontrolled" state regulation (Pet. Br. at 23), or to curtail "multiple" (*i.e.*, "state") proceedings. (*Id.*)

Before enactment of the FPA, only the states regulated the practices of utilities. There was no federal agency to deal with *inter*state matters. The foreclosure of the states from the latter by the Commerce Clause resulted in a "regulatory gap"—the absence of any *inter*state regulation—a result that flowed from the jurisdictional "bright line" between federal and state jurisdiction drawn by the Court in *Attleboro*.[47] In response, Congress created the Federal Power Commission ("FPC," now FERC) with authority to set interstate wholesale rates and thus to fill this "gap," but it did so with deliberate care not to detract whatever from the power of the states. *Federal Power Comm'n v. Southern Cal. Edison Co.*, 376 U.S. 205, 211 (1964). According to contemporaneous testimony by the FPC, "[t]he [Act] simply fills this gap and *that is all.*" *Public Utility Holding Companies: Hearings on H.R. 5423 Before the House Comm. on Interstate and Foreign Commerce*, 74th Cong., 1st Sess. 549 (1935) (emphasis added).

Thus, the statute itself, Section 201 of the Act, 16 U.S.C. § 824, describes the matters as to which the FERC may

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[47] *Public Util. Comm. v. Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927).

act but adds, "such Federal regulation, however, to extend *only* to those matters which are *not subject to regulation by the States*"; and it further denies FERC jurisdiction "over facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce." 16 U.S.C. § 824(a) and (b)(1) (underscore added).

The legislative history is unusually explicit. The Senate Report explained that the final bill:

> *removed every encroachment upon the authority of the States.* The revised bill would impose Federal regulation *only* over those *matters which cannot effectively be controlled by the States.* The *limitation* on the Federal Power Commission's jurisdiction in this regard has been inserted in *each* section in an effort to *prevent* the expansion of Federal authority over State matters.

S. Rep. No. 621, 74th Cong., 1st Sess. 18 (1935) (emphasis added). The purpose was "not to impair or diminish the powers of any State commission." *Id.* at 48. The House Report was equally emphatic:

> The new parts are so drawn as to be a complement to . . . State regulatory authority . . . . Probably, *no bill in recent years has so recognized the responsibilities of State regulatory commissions as does Title II of this bill* [the FPA].

H.R. Rep. No. 1318, 74th Cong., 1st Sess. 8 (1935). The Act was "directed to the purpose of supplementing and assisting and not encroaching upon State regulation or the sovereign powers of the States." *Public Utility Holding Company Act of 1935: Hearings on S. 1725 Before the Senate Committee on Interstate Commerce*, 74th Cong., 1st Sess. 249 (1935). As the Court stated,

> The Act . . . had *no* purpose or effect to cut down state power. On the contrary, perhaps its primary purpose was to *aid in making state regulation effective* . . . .

Panhandle Eastern Pipeline Co. v. Public Serv. Comm'n of Indiana, 332 U.S. 507, 517 (1947) (emphasis added).[48] Congress was "meticulous to take in only territory which this Court had held the states could not reach." *Id.* at 519.

Contemporaneously, the Public Utility Holding Company Act ("PUHCA"), 15 U.S.C. §§ 79-79z-6, was passed in part to insure that individual companies that were part of a *multistate* utility holding company were made *more* responsive to local interests and regulation[49] and that the holding companies not be so large as to impair the advantages of "localized management . . . and the effectiveness of regulation." 15 U.S.C. § 79b(a)(29).

At the same time, Congress passed the Johnson Act, 28 U.S.C. § 1342, declaring that disputes over utility retail rates based on federal constitutional challenges should be adjudicated in state courts. The purpose was to "limit the authority of the public utility corporations to . . . impede the states in their regulatory actions." (Testimony of Sen. Hiram W. Johnson, sponsor of the Act, 78 Cong. Rec. 8335 (1934)). See n.45 *supra*.

There is not the slightest indication that rights were given to the states to participate in FPC (FERC) proceedings so that FERC could act as a "single neutral federal forum" for a dispute between a state regulator and its jurisdictional utility (much less, as to a matter involving

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[48] The "Act" referred to in *Panhandle* was the Natural Gas Act, but it is "established practice" to cite decisions interpreting the FPA or NGA "interchangeably." *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1981).

[49] The accompanying Senate Report stated,

> An operating system whose management is confined in its interest, its energies, and its profits to the needs, the problems, and the service of one regional community is likely to serve that community better, to confine itself to the operating business, to be amenable to local regulation . . . and responsible to the fair demands of the public . . . .

S. Rep. No 621, 74th Cong., 1st Sess. 12 (1935).

its local management) as opposed to acting neutrally between different jurisdictions. (Compare Pet. Br. at 24.)

The statutory scheme directly affects how the claim of preemption here must be resolved. State action is deemed preempted when Congress has expressed a clear intent (a) to preempt state law, *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977), or (b) to "occupy the field" and leave no room for state law. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). Otherwise, state action is preempted only to the extent that it (c) *actually* conflicts with federal law, *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-143 (1963), or (d) "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). Since Congress did not intend to preempt state regulation, but to preserve it and limit federal encroachment, it is necessary to conduct a careful "conflict-preemption analysis," which

> must be applied sensitively in this area, so as to prevent the diminution of the role Congress reserved to the States while at the same preserving the federal role.

See Northwest Cent. Pipeline Corp. v. State Corp. Comm'n, 489 U.S. 493, 515 (1989). Moreover, where, as here, the states' police powers are implicated, 491 U.S. at 365, the Court "start[s] with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the *clear and manifest purpose* of Congress." *Wisconsin Public Intervenor v. Mortier*, 111 S. Ct. 2476 (1991). (emphasis added). There is no basis upon which FERC can be said to have had the authority to (much less have taken action to) displace the Council categorically here from examining a legitimate matter of local regulatory concern.

B. There Is No Substantive Or Jurisdictional Conflict Between The Council's And FERC's Actions

1. The Council's Order Properly Addressed Matters Within Its Jurisdiction

The Rate Order sets only retail rates, accepts FERC's allocation of costs, recognizes that they must be reflected in retail rates and imposes a disallowance only by reason of management's negligence and consequent failure to realize offsetting revenues in other transactions. J.A. 72, 201. It avoids even indirect financial impact on petitioner's obligations. *See* J.A. 242-43. Nor are petitioner's costs passed to ratepayers in other states.[50] Rather, the Order requires, as a "normal ratemaking step," that the utility investors take appropriate responsibility for imprudent management. 491 U.S. at 367. There is no Congressional purpose to insulate such investors from the consequences of mismanagement at the retail level.

2. The FERC Did Not and Could Not Address the Issues Addressed By The Council

The issue before FERC was the fair *allocation* of the costs of Grand Gulf *among* the companies that sponsored the project, 31 FERC at 61,632; 32 FERC at 61,943. The result was a "just, reasonable and non-discriminatory" wholesale power rate. The opposing parties, however, try to shift the meaning of this phrase—that the underlying costs were properly incurred and that the allocation formula is fair—to one of asserting that this "fair" share of a potentially uneconomic (ultimately, "catastrophically uneconomic") plant was, in actuality, good for a company and its ratepayers. See S.G. Br. at 5, 14. The underlying fallacy is the notion that power *must* be retained if allocated by FERC. They contend that it is *proper* for petitioner's man-

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[50] The complaint does not allege that petitioner's costs were passed on to other companies. Also, petitioner's president testified that Grand Gulf cost absorptions by the *other* operating companies did not shift any costs to NOPSI and that effects were confined to each company. J.A. 99.

agement to act negligently and retain power—even if, *in fact*, there were legitimate cost concerns and management had resale alternatives—but *improper* for management to take action to address such problems by, say, the very sales that petitioner's management testified it could make.[51]

Of course, FERC here had no actual or even arguable concern with such issues. Rather, FERC deemed local factors *irrelevant* to the issue of allocating the plant costs fairly among the several companies, 487 U.S. at 376. Further, an inquiry into the prudence of the management of a buying company regarding its risk-reduction options was not even within the FERC's own view of its jurisdiction and "not generally within the scope of issues considered in reviewing the rates and terms for the jurisdictional sale of power." (*See* n.14 *supra*.) FERC has never evinced any interest in whether petitioner might resell part of its Grand Gulf power, but only that it accept responsibility for a fair portion relative to the other companies.

The issue of NOPSI's *failure* to seek off-system sales could not have been raised at the FERC at all (much less for the purpose of setting a *retail* rate, the only matter involved here). The FERC has power only to approve the rate (and terms) of an interstate transaction *actually filed* with it for approval, 16 U.S.C. § 824e. (Contrast Section 7 of the Natural Gas Act, 15 U.S.C. § 717f (1982), granting FERC certification authority.) Further, it confines this review to the components of the rate itself, *i.e.*, to the *seller's* cost factors and practices. *Monongahela Power Co.*, 39 FERC ¶ 61,350, at 62,095 (1987). Here, where the problem is that a retail utility *failed* to engage in a transaction, there is *no* rate to file at FERC to invoke its jurisdiction—much less to stimulate a wholly *unprecedented* FERC inquiry into the prudence of the *buying* utility's resale practices. As a result, if no state review were possible, the

[51] The same fallacy (and others) underlies the supposed impossibility of coexistence of certain propositions propounded in the government's brief (S.G. Br. at 20).

utility here would escape regulation entirely and frustrate Congress' purpose to close the regulatory "gap."

Indeed, the only situation in which the prudence of petitioner's *not* making off-system sales could, in theory, have properly been raised before FERC would have been in a proceeding where a hypothetical *wholesale customer* of NOPSI, whose rate was based on NOPSI's Grand Gulf costs, contended that that rate was too high, by reason of NOPSI's failure to sell-off Grand Gulf power. Here, there was never such a complaint filed and thus no basis on which FERC could acquire jurisdiction to consider the matter. This situation would, moreover, provide no way for the Council to raise the matter.[52] *Cf. Monongahela Power Co.*, 39 FERC at 62,096.

The government attempts to confect a basis for FERC jurisdiction by the expedient of *altering* the subject matter of the prudence inquiry. Thus, it contends that an assertion that "Grand Gulf costs should have been disallowed . . . because the *project* . . . should have been sold off-system" could have been raised before FERC (S.G. Br. at 18) (emphasis added); and that the Council "could have argued, for instance, that it was imprudent for *MSE* to have failed to sell more than 10% of Grand Gulf off-system" (S.G. Br. at 19, n.10 (emphasis added). These contentions are irrelevant. The Council's inquiry involved the actions of NOPSI, not of MSE. Further, the Council did not determine whether the "system" should have sold either the "project" or additional power because such a determination is beyond its jurisdiction and involves other factual considerations. Similarly, the Council expressed no view as to whether—for overall "system" planning or fuel mix—the amount of Grand Gulf power retained by the "system" was appropriate. The jurisdiction of FERC to decide one issue can

[52] In oral argument in *MP&L*, Mississippi's Attorney General was asked whether, "[A]ll of the arguments that Mississippi wished to present now with reference to prudence could have been made before FERC," and agreed that they could have been. (Transcript at 36-37, No. 86-1970, Feb. 27, 1988.) The Council's situation is entirely different.

hardly be established by pointing to its jurisdiction to decide a different issue involving a different entity's prudence.[53]

Further, the opposing briefs posit FERC jurisdiction because they say, FERC determines prudence as to "*any and all* claims that a utility behaved imprudently after construction of the plant was 'underway' " (Pet. Br. at 26) and has "considered claims that it was imprudent for *a utility* to fail to sell off nuclear power while construction of the plant was underway"[54] (S.G. Br. at 18, n.9, emphasis added) citing, in particular, *Connecticut Power & Light Co.*, 43 FERC ¶ 63,029 (1988), *aff'd* 48 FERC ¶ 61,139 (1989). Such contentions are inaccurate and phrased so as to hide the key distinction that FERC has considered *only* the prudence of the *seller* of power when the seller files a wholesale rate for approval—just as described in the hypothetical case stated at p. 35 *supra*. In the *Connecticut Power* case, for example, FERC considered the contention that the *seller* of power from a nuclear plant should have sold off its entitlements to lower the overall costs to certain customers. (The analogy would be that MSE should have sold off additional Grand Gulf power to reduce its aggregate costs; but this is not the issue here.)

None of the cases cited in the opposing briefs on this issue has bearing here, because all involve FERC deter-

[53] For the same reason, the government's contention that NOPSI's prudence could have been placed in issue so as to "reduce NOPSI's *relative* share" of the allocation is irrelevant. (S.G. Br. at 19 n.10, emphasis added.) There is no nexus between the fairness of NOPSI's relative allocation of power and NOPSI's failure to resell power.

[54] The coincidental use of the word "underway" by both opposing parties is a play on language in the Fifth Circuit's decision below. The Fifth Circuit posed the question whether FERC had jurisdiction to determine "whether NOPSI acted prudently once the Grand Gulf project was underway." J.A. 25. However, the word "underway" referred to the time of the events, and not to the basis for the Court's decision. The Court found that the Council could inquire into the issue of reducing costs through other means, J.A. 26, and such means were off-setting sales. J.A. 39.

minations, in setting a wholesale rate, whether a *seller* properly completed or abandoned construction of a particular plant (or part thereof)[55] or whether the initial agreement among companies to participate was proper.[56] These decisions have nothing to do with whether a *buyer*—such as petitioner—had the opportunity to sell a portion elsewhere but negligently bypassed it, with consequent impact on its retail rate. The opposing briefs have cited *not a single case* in FERC's history in which FERC has undertaken to determine whether a *buyer* of wholesale power should have engaged in offsetting transactions or addressed the attendant consequences. The FERC has consistently declared such matters to be beyond its statutory responsibility.

It did so here. MSE submitted a proposed finding that the "purchases by LP&L, MP&L and NOPSI of their respective allocations . . . are prudent and will . . . move each company toward having its proportionate share of base (coal and nuclear) generation." Initial Brief of MSE at 154 (July 3, 1983), Proposed Finding No. 21, *Middle South Energy Inc.*, No. ER82-616. The finding was opposed by FERC

[55] *See New England Power Co.*, 8 FERC ¶ 61,054 (1979) (plant cancellation), *aff'd sub nom., NEPCO Municipal Rate Committee v. FERC*, 668 F.2d 1327 (D.C. Cir. 1981), *cert. denied*, 457 U.S. 1117 (1982); *Southern California Edison Co.*, 8 FERC ¶ 61,198 (1979) (plant cancellation), *aff'd sub nom., Anaheim, Riverside v. FERC*, 669 F.2d 799 (D.C. Cir. 1981); *Minnesota Power & Light Co.*, 11 FERC ¶ 61,312 (1980) (retirement of pollution control device); *Northern States Power Co.*, 17 FERC ¶ 61,196 (1981) (plant cancellation), *aff'd sub nom., South Dakota Public Utilities Comm'n v. FERC*, 690 F.2d 674 (8th Cir. 1982); *Arizona Public Service Company*, 27 FERC ¶ 61,185, at 61,351 (1984); *Arizona Public Service Company*, 23 FERC ¶ 61,419 (1983), *summarily aff'g*, 21 FERC ¶ 63,007 (1982) (continued construction); *New England Power Co.*, 32 FERC ¶ 61,112 (1985) (plant cancellation), *aff'd subnom., Violet v. FERC*, 800 F.2d 280 (1st Cir. 1986); *Union Electric Co.*, 40 FERC ¶ 61,046 (1987) (plant construction); *New England Power Co.*, 42 FERC ¶ 61,016 (1988) (plant cancellation). *See also Regulation of Electricity Sales-For-Resale and Transmission Service*, FERC Statutes and Regulation, ¶ 35,519 (1985).

[56] *New England Power Co.*, 32 FERC ¶ 61,112 (1985), *aff'd sub nom., Violet v. FERC*, 800 F.2d 280 (1st Cir. 1986).

Staff on the basis that: "The Commission has repeatedly stated that it does not view its responsibility under the Federal Power Act as including a determination that a purchaser selling at retail has purchased wisely or made the best deal available, i.e., the prudence of a purchase." Reply Brief of Commission Staff at 36, ER82-616 (Aug. 10, 1983). It was not adopted.

Apart from misstating the prudence issue, the government appears to argue that the Court should endow FERC with a new ancillary jurisdiction that it might exercise as a prophylaxis against state regulatory misbehavior. In addition to the lack of merit in such a course, it is simply precluded by the jurisdictional limits imposed by Congress, which do not presume a need for FERC to invade state regulation, but rather a need to protect state regulation from FERC invasion. The government's position would clearly require a legislative turnabout.

3. The FERC's New "Jurisdictional" Position Would Encroach Upon State Regulatory Rights

Because the determination by the Council was within its jurisdiction, it is not surprising that it does not, in any way, "undercut" or "nullify" the FERC's order. Petitioner can comply with the Council's Order as well as with FERC's. The opposing arguments would instead radically undermine state prerogatives, with inappropriate results.

The government argues that "any order" that does not allow a utility to recover the cost of power that FERC had required it to buy "necessarily undercuts FERC's determination" that the "terms are just and reasonable" (S.G. Br. at 12), and that the order is precluded because it would "prevent NOPSI from recovering the very costs that FERC has determined are just and reasonable" (S.G. Br. at 14). These arguments shift the meaning of "just and reasonable." *See* pp. 33-34, *supra*. They are in irreconcilable conflict with the language of *NOPSI III*. 491 U.S. at 367. Further, they lead to the result that if NOPSI had sold part of its Grand Gulf power, in any manner, the FERC-allocated costs would *still* have to be reflected in retail

rates, without offset from the sale proceeds, because once the FERC had allocated the "just and reasonable costs," they *must* appear in retail rates. Similarly, if the evidence showed that NOPSI's management had an opportunity to sell power, but declined to do so (say, because it was cooperating in a scheme to downplay problems at Grand Gulf), the retail regulator could not take that into account.

The related contention that a rate order is "facially" preempted if it "traps" any portion of FERC-mandated costs "on the ground that it was imprudent for NOPSI to incur them" (S.G. Br. at 11) is purposefully ambiguous as to whether it refers to the initial imposition of power costs or the decision by management not to pursue options to reduce costs. This Court has used the term "trapping" to describe *only* a local regulator's refusal to recognize FERC-allocated costs based on its attempt to decide a matter within FERC's jurisdiction, and *not* to describe any offsets, penalties or deductions for improper acts by the utility's management properly within the purview of the local regulator.[57] There cannot be an improper "trapping" of costs when a regulator offsets the proceeds of sales that have been, or should have been, made.[58]

The opposing arguments would simply license negligent management to do nothing to protect its ratepayers from undue risks as to any allocation of power approved by FERC, even if the *facts* show that it should have done so. To detract from this, the government contends that the states will misbehave—that, if the Council can undertake this inquiry, so could all other "interested retail ratemakers," with the "upshot" that the states could "respond"

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[57] In another case, FERC is currently arguing that the "principle of impermissible trapping is a very *narrow* rule" arising "only" where "state and federal agencies regulat[e] *precisely the same subject matter*." FERC Br. at 14 (May 24, 1991), *Ohio Power Co. v. FERC*, No. 88-1293 (D.C. Cir.) (emphasis added).

[58] State regulators have exclusive jurisdiction to determine how retail rates should be adjusted to account for revenues obtained through off-system wholesale sales. *Public Service Co. of Indiana*, 51 FERC ¶ 61,367, at 62,213-214 (1990).

by refusing to pass on FERC-allocated costs because of off-system sale opportunities (S.G. Br. at 22). Identically, NOPSI asserts that it is "always possible" for the retail regulator "to make (or contrive) a finding that a prudent utility should have minimized" its exposure by off-system sales. (Pet. Br. at 43.) These arguments would deny state regulators power to investigate matters within their jurisdiction based on the cynical premise that states will "respond" without, or will "contrive," evidence of mismanagement in order to evade FERC costs. They are a direct attack on the Congressional allocation of retail oversight to the states. Further, they assume erroneously that the "contrived" responses of state regulators will remain undisciplined by judicial review—by means of the very *factual* inquiry that the opposing parties seek to prevent here. Allowing state inquiries to go forward permits the *inquiry* to take place, but it does not authorize an improper deduction to stand.

Here, the Council found that the economics of Grand Gulf I had become problematical during the 1979-80 period; and that petitioner, facing a large commitment, should have taken steps to diversify by seeking off-system sales. Although the possibility of power sales was much on management's mind, it did nothing.[59] J.A. 141-43.

The availability of retail level review will promote different behavior—like that of Public Service of New Mexico

[59] The Council's findings, well-based in the evidence, relied on expert testimony; testimony by petitioner's president and its senior vice president that the power was marketable; a history of off-system power sales by the operating companies; that off-system sales of the power were later attempted, but too late; that the system agreements had been amended to facilitate off-system sales; and other factors. J.A. 197-203; *Alliance for Affordable Energy*, 578 So. 2d at 962-64. Petitioner adverts to the district court's belief, expressed in an earlier opinion, *before* it had the factual record, that the Rate Order rested upon NOPSI's finding a "sucker" to buy power (Pet. Br. at 39, 44); but, with deference, this was factually incorrect (J.A. 202) as was the court's belief that the disallowance was the same as had been sought at FERC. J.A. 242. Notably, the district court made no similar observations here, *after* it had the factual record.

("PSNM") with respect to its participation in the Palo Verde nuclear plant during 1979 when it,

> took several steps to manage the effects on its generating capacity of external events . . . [including] a series of strategies . . . attempts to reduce PSNM's share of Palo Verde by selling ownership, selling portions of the coal-fired San Juan plant and leveling Palo Verde's cost through sales-leaseback transactions . . . .[60]

The Council required that petitioner be accountable to the ratepayers, exercise diligence with respect to its power commitments, and manage its risks through available alternatives. Had petitioner done so, it would not have undercut *any* obligation established by the "system" or FERC, and would have remained responsible for its share of costs and had offsetting revenues. J.A. 201. (The effect at the time would have been to spread the risks of Grand Gulf—prospective future benefits as well as losses—more widely.) But petitioner did nothing.

4. The *MP&L* And *Nantahala* Decisions Do Not Foreclose The Council's Actions

If the Council's disallowance of retail rates to reflect on NOPSI's negligence in bypassing cost-reducing options were "facially" barred by *MP&L* or *Nantahala*, then it would hardly have been possible for the Court in *NOPSI III* to say that, "Nothing in this is directly or even indirectly foreclosed" by federal law. 491 U.S. at 367.

In *Nantahala*, FERC determined the allocation of electricity costs between two utilities located in different states. North Carolina, however, "expressly rejected the fairness" of FERC's allocation, 476 U.S. at 961, and, in setting retail rates, "chose an allocation . . . that differ[ed] from" the FERC's. 476 U.S. at 955. The Court held that, under the "filed rate doctrine," the "NCUC's allocation" is preempted." 476 U.S. at 955; and that the state order had

[60] *Electric Utility Week*, Feb. 6, 1989 at 13 (summarizing testimony).

thus "trapped" costs in finding "Nantahala should have obtained more of the low-cost" power than allocated by FERC and setting retail rates on that basis. *Id.* at 968; 971-72.

The Court made clear that retail considerations, including the recognition of savings, could properly be taken into account, and did not suggest that their offset against costs would constitute impermissible "trapping." *Id.* at 967-68. Further, the Court distinguished the "*Pike County*[61] line" of cases on the basis of the *choiceless* nature of the utility's situation, noting that "no source of power besides entitlement and purchased power from TVA is said to be available" (*id.* at 973). Here, in contrast, the Council accepted both the price and quantity set by FERC, but focused on available choices—off-setting transactions—that both NOPSI's management and expert witnesses stated NOPSI could have pursued. J.A. 201.

MP&L presented the narrow question, "[W]hether the FERC proceedings have preempted" the state's inquiry into "the prudence of the management decisions that *led to the construction and completion* of Grand Gulf 1." *MP&L*, 487 U.S. at 356 (emphasis added).[62] The state supreme court had identified certain "prudence" issues to be addressed, each plainly committed to FERC's exclusive jurisdiction, *viz*: (1) whether Grand Gulf power was "not needed" and

[61] *Pike County Light & Power Co. v. Pennsylvania Pub. Util. Comm'n*, 465 A.2d 735 (1983) and the FERC's decisions hold that where a utility has choices among power sources, the fact that the FERC has prescribed a "just and reasonable rate" for one source does not mean that the utility can ignore the availability in fact of lower-cost power.

[62] In *MP&L*, the Court referred to ALJ Liebman's statement that "continuing *construction* of Grand Gulf Unit 1 was prudent" because management "believed" that Grand Gulf would result in lower costs than "existing alternatives on the system." *Id.* at 363 (quoting 26 FERC at 65,112) (emphasis added). NOPSI reorders the ALJ's words and inserts its own time frame, stating that the Council's order conflicts with a FERC "finding" that MSU "prudently" believed "in 1980" that Grand Gulf would cost "less than existing alternatives." Pet. Br. at 22. This is incorrect. The statement did not say either that the time-point was 1980; or that MSE's management "prudently" believed. As indicated *infra* at 46-47, it was no "prudence" finding at all.

had been set "at a price that is not prudent," 487 U.S. at 367; (2) "whether MP&L, [MSE] and MSU acted reasonably when they constructed Grand Gulf 1," *id.* at 368; (3) "whether the completion of Grand Gulf, or its continued operation, was prudent," *id.* at 368; (4) whether the "transactions *between* MP&L, [MSE], and MSU" were reasonable, *id.* at 376 (emphasis added); and (5) whether retail rates could be set on the "assumption that MP&L is obligated to purchase less Grand Gulf power than FERC has ordered it to purchase." *Id.* at 373. These matters implicated the "overall interests of the affiliated group rather than the particular interest of the individual affiliate." 487 U.S. at 382 (Scalia, J., concurring). The state "failed to raise" these issues before FERC, which "easily could have considered [them] in determining whether to permit *MSE* to recoup 100%" of its costs. *Id.* at 375 (emphasis added).[63]

In contrast, the Council (1) did not question the decision to construct or complete Grand Gulf or NOPSI's participation in it; (2) did not question the price; and (3) accepted the FERC's allocation. The Council reached its decision based on substantial evidence that management should have sold power—evidence without counterpart in *MP&L*.[64]

5. There Are No Substantive Conflicts Between The Decisions of The Council And FERC

In *NOPSI III*, petitioner also advanced a list of alleged conflicts between the FERC's and the Council's findings

[63] NOPSI speculates what the Mississippi PSC "would have addressed" had its prudence inquiry proceeded, seeking to assimilate it to the Council's proceeding (NOPSI Br. at 32). Of course, none of these matters was mentioned by the state court or by this Court in *MP&L*, and NOPSI provides no support for its view.

[64] NOPSI refers to the Council's arguments as *amicus* in the *MP&L* case (NOPSI Br. at 31 n.39), but it ignores that the key position of the Council in its *amicus* brief was that *MP&L* not be decided in a broad way that would undercut the Council's prudence proceedings, which were different from those contemplated in Mississippi. The *MP&L* result was consistent with that position.

as a basis for "facial" preemption, *see* n.37 *supra*, but the Court did not mention them or suggest that alleged *factual* conflicts were to be dealt with as a *facial* issue. Even if there were such differences between the findings of the Council and the FERC, it would not mean that the Council's Order was "facially" preempted, but, at most, that the Council might be bound by certain findings, although the matter is not clear nor at issue here.[65] There are, however, no conflicts between the FERC's determinations and those of the Council, but only between the opposing parties' misportrayals of each.

As an overview, the opposing parties largely confuse two different levels of concern, *viz*: (1) decisions to participate in, construct and complete the plant; and (2) an individual company's options while the plant goes forward or is completed. An example will clarify: Assume that NOPSI had been one of several companies that had agreed to finance construction, not of a nuclear plant, but of a large building, by guaranteeing to take a portion of its space, and that based on this, the building's owner, SERI, obtained financing. During construction, costs increased, and the economic desirability of the space became problematic. As the building reached, say, 70 percent completion, a decision had to be made whether (a) to curtail construction and leave it a partially completed shell, or (b) to complete it with the expectation that it would be usable and might be economic.

The first set of issues—whether to invest initially and later to complete—are obviously different both in nature and timing from the issue of how NOPSI should act with regard to *its* obligation to take and pay for space. Clearly, neither the building's completion nor NOPSI's commitment

[65] The court below suggested in *dictum* that if there were factual conflicts, which it found not to be the case, "the Council would have been bound by FERC's resolution of those issues." JA-25 n.5. However, FERC considers that a state commission and the FERC may make independent factual findings on matters within their respective jurisdictions even if they do conflict. *Monongahela Power Co.*, 39 FERC ¶ 61,350, at 62,096 (1987).

to pay for space would prevent NOPSI's subleasing to others. By entering into contracts to sublet, for example, NOPSI would remain liable for payments—but would receive offsetting revenues. The nature of the problem remains the same whether the amount of NOPSI's space commitment[66] was fixed by a contract, allocated by a formula, or set by a federal commission.

Thus, management's obligation to *retail ratepayers* to evaluate risks and pursue available options is not the same issue as management's obligation to *the system* for a share of the plant. Further, the computations underlying these issues are themselves different (n.11 *supra*).

Turning to the specific alleged conflicts, the Rate Order does not "effectively reallocate" Grand Gulf costs among the companies (compare S.G. Br. at 23). The Council made no reallocation or any finding as to how much Grand Gulf power MSE should hold or sell but rather confined its determinations to NOPSI's situation. Thus, the Council's findings did not affect the *relative* cost responsibilities *among* the operating companies (*compare* S.G. Br. at 16, 19)—just as the disparate settlements reached with the MSU operating companies, involving cost absorptions, did not shift their Grand Gulf costs *relative* to petitioner. J.A. 98-99.

Second, the disallowance is not inconsistent with FERC's findings regarding either the system's diversification or continued construction of Grand Gulf (compare S.G. Br. at 24). Neither circumstance required that NOPSI's management avoid the usual practice of adjusting its power and fuel mix needs to meet its own public service responsibility. The facts show that the companies were not only free to do, they were expected and obligated to do so. *See* pp. 4-5 *supra*; 31 FERC at 61,656; 32 FERC at 61,957.

Third, ALJ Liebman's statement that "continuing construction of Grand Gulf Unit No. 1 was prudent because

[66] The same analogy used here could be developed using, say, an obligation to take a quantity of raw materials or the output of a manufacturing plant.

Middle South executives believed Grand Gulf would enable the Middle South system to diversify . . . and, it was projected at the same time, produce power for a total cost . . . less than existing alternatives on the system" (26 FERC at 65,112-65,113) is not in conflict with any of the Council's determinations and was not a finding on any legal issue of "prudence."[67] Further, it addressed only the *continuing construction* of Grand Gulf, not whether NOPSI should *retain* power it stood to receive. Moreover, the statement addressed only a comparison between Grand Gulf and "existing alternatives *on the system*"—not all relevant power alternatives. Coal power was not "on the system" until 1980 when Grand Gulf was more than 70% complete.[68]

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[67] Exploring the alleged basis of the FERC's "finding" on prudence, asserted by petitioner, demonstrates that it is inappropriate to attribute to FERC "determinations" of matters not even before it, *see* n.12 *supra* much less actually addressed by it. ALJ Liebman's language was neither directed to any *issue* of, nor phrased to reflect the legal standard of, prudence. Rather, it was a response *only* to New Orleans' argument that the FERC was obligated to use a "peak responsibility" allocation method because Grand Gulf had been initiated on the basis of a "load growth" justification. 26 FERC at 65,112. ALJ Liebman answered that the justification changed to one of "fuel diversification and fuel replacement" and stated that MSU executives "*believed*" that Grand Gulf would enable the system to diversify and produce power for a total cost less than "*existing alternatives* on the system." *Id.* at 65,112-65,113 (emphasis added). The legal test of "prudence," however, is *not* met by "beliefs," but rather by whether they were objectively reasonable in the circumstances, *see* J.A. 90-94—a matter not explored in the FERC proceeding. Also, as indicated in accompanying text and the next footnote, other necessary prudence factors were simply not included. FERC itself never addressed any of this, but merely generally accepted ALJ Liebman's findings as they related to the choice of allocation method. 31 FERC at 61,666. In *MP&L*, the Court noted that the FERC had not discussed prudence but had "implicitly accepted the uncontroverted testimony of the MSU executives" as to why they continued to construct Grand Gulf and had "approved the finding" made by ALJ Liebman in the context noted above—*not* that the FERC had in fact made a finding on prudence. 487 U.S. at 363.

[68] ALJ Liebman adverted only to "existing alternatives on the system," 26 FERC at 65,112-65,113, gas and oil fired. (See 26 FERC at 65,101.) He had made the *same* point earlier:

> *In the 1970's* with the reduced load growth forecasts on the Middle South system, it became evident that Middle South no longer needed the capacity. . . . However, based on its projections for the cost of Grand Gulf and the increasing price of oil, Middle South anticipated that, even though it would have excess system capacity with the addition of Grand Gulf, the average overall cost per kilowatt-hour of electricity would be less than it would be if the system *continued to rely upon oil- and gas-fired generation.*

26 FERC at 65,102 (emphasis added). Yet the coal power issue was critical to prudence determinations. *See J.A.* 170, 188, 194.

There is no reference to *when* Middle South executives held such belief or *when* the projections held true; yet, the timing of such events are critical in prudence determinations. These were unaddressed by FERC—except in marginalia that *support* the Council's determinations. (*See* p. 7, *supra*..)

While petitioner states that the Council's findings were made by reviewing "the *same* evidence of the MSU's system's Grand Gulf decisionmaking" that was before the FERC (*id.*), but FERC's findings on such evidence do not conflict with the Rate Order, and virtually none of the key evidence developed at the Council (regarding, *e.g.*, the alternatives available to NOPSI, lack of restraint on resales, the time when Grand Gulf power appeared potentially uneconomic, the relative costs and availability of power, the acts and omissions of NOPSI's management, and more) was before FERC—for the very reason no prudence issue of any kind was addressed there.

Fourth, the government's contention that it was inappropriate for the Council to assume that NOPSI's resales of power for its own account would *not* be recaptured by FERC and redistributed to other companies (notwithstanding that NOPSI had satisfied the entirety of the obligation FERC assigned to it) is not only unreasonable and unsupported by any FERC precedent (none of which suggests any FERC interest in, or power to, reattribute such sales), it is contrary to Opinion 234 itself. The FERC determined

that NOPSI's "just, reasonable and non-discriminatory" allocation of Grand Gulf was 17%, no more or no less. The government's argument rests on the impermissible assumption that the FERC might have taken a different action see *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981)—that is, one effectively requiring NOPSI to have taken even a larger share of Grand Gulf and becoming responsible not only for the power allocated to it—some held, and some sold-off—but yet more power as well. The entire argument is so speculative and beyond the range of existing FERC precedent that it deserves no weight.

Finally, petitioner's contention that the Council's findings are "preempted" because the system agreement required "system-wide planning and foreclosed individual MSU operating companies from engaging" in off-system transactions (Pet. Br. at 40) is just a quarrel with the facts. System-wide planning for overall fuel mix and capacity was never deemed inconsistent with the companies taking individual actions to achieve a mix of power sources. J.A. 119-120; 31 FERC at 61,656; 32 FERC at 61,957. Moreover, the contention that the other companies would have frustrated NOPSI's off-system sale was raised during the hearings and fell apart during cross-examination. J.A. 200.

CONCLUSION

For the reasons stated, the Court should either (1) affirm the decision below or (2) reverse with the direction that the district court's judgment should be vacated and the action dismissed in light of the prior state court judgment.

Respectfully submitted,

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September 6, 1991

APPENDIX

APPENDIX

STATUTES

28 U.S.C. § 1738:

* * * *

The records and judicial proceedings of any court of any such State, Territory or Possession, or copies thereof, shall be proved or admitted in other courts within the United States and its Territories and Possessions by the attestation of the clerk and seal of the court annexed, if a seal exists, together with a certificate of a judge of the court that the said attestation is in proper form.

Such Acts, records and judicial proceedings or copies thereof, so authenticated, shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken. June 25, 1948, c. 646, 62 Stat. 947

La. Code Civ. Proc. Ann. art. 531 (West 1960):[1]

When two or more suits are pending in a Louisiana court or courts on the same cause of action, between the same parties in the same capacities, and having the same object, the defendant may have all but the first suit dismissed by excepting thereto as provided in Ar-

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[1] Article 531 was amended effective January 1, 1991, in a manner not relevant here, as follows:

La. Code Civ. Proc. Ann. art. 531 (West Supp. 1991):

When two or more suits are pending in a Louisiana court or courts on the same transaction or occurrence, between the same parties in the same capacities, the defendant may have all but the first suit dismissed by excepting thereto as provided in Article 925. When the defendant does not so except, the plaintiff may continue the prosecution of any of the suits, but the first final judgment rendered shall be conclusive of all.

ticle 925. When the defendant does not so except, the plaintiff may continue the prosection of any of the suits, but the first final judgment rendered shall be conclusive of all.

La. Civ. Code Ann. art. 3556 (31) (West 1953):

Thing Adjudged.-Thing adjudged is said of that which has been decided by a final judgment, from which there can be no appeal, either because the appeal did not lie, or because the time fixed by law for appealing is elapsed, or because it has been confirmed on the appeal.

La. Rev. Stat. Ann. 13:4231 (West 1991):

Except as otherwise provided by law, a valid and final judgment is conclusive between the same parties, except on appeal or other direct review, to the following extent:

(1) If the judgment is in favor of the plaintiff, all causes of action existing at the time of final judgment arising out of the transaction or occurrence that is the subject matter of the litigation are extinguished and merged in the judgment.

(2) If the judgment is in favor of the defendant, all causes of action existing at the time of final judgment arising out of the transaction or occurrence that is the subject matter of the litigation are extinguished and the judgment bars a subsequent action of those causes of action.

(3) A judgment in favor of either the plaintiff or the defendant is conclusive, in any subsequent action between them, with respect to any issue actually litigated and determined if its determination was essential to that judgment.

Johnson Act, 28 U.S.C. § 1342 (1982)

The district courts shall not enjoin, suspend or restrain the operation of, or compliance with, any order affecting rates chargeable by a public utility and made by a State administrative agency or a ratemaking body of a State political subdivision, where:

(1) Jurisdiction is based solely on diversity of citizenship or repugnance of the order to the Federal Constitution; and,

(2) The order does not interfere with interstate commerce; and,

(3) The order has been made after reasonable notice and hearing; and,

(4) A plain, speedy and efficient remedy may be had in the courts of such State.

June 25, 1948, c. 646, 62 Stat. 932

(16)

NO. 90-1156

Supreme Court, U.S.
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In the
Supreme Court of the United States

October Term, 1990

NEW ORLEANS PUBLIC SERVICE, INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, et al.,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR RESPONDENTS THE ALLIANCE FOR AFFORDABLE ENERGY, INC., et al.

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QUESTION PRESENTED

Whether a State-Authorized Utility Regulator, in Setting Intrastate Retail Rates for Electricity, Has Authority to Determine Whether a Local Utility Acted Imprudently in Failing to Diversify Its Power Supply Portfolio And in Failing Even to Investigate Off-System Sales of Power?

RULE 29.1 STATEMENT

Respondent The Alliance for Affordable Energy, Inc. is a Louisiana non-profit corporation. It has no parent company or subsidiaries. Citizens for Safe Energy, Inc. is a Louisiana non-profit corporation. It has no parent company or subsidiaries.

TABLE OF CONTENTS

Question Presented ii

Rule 29.1 Statement ii

Table of Contents iii

Table of Authorities. vii

Citation of Opinions. 1

Counterstatement of the Case. 2

A. The Parties 2

B. Historical Background -- Grand Gulf Costs 5

C. NOPSI'S Grand Gulf Costs. . 8

D. FERC Proceedings. 10

E. NOPSI I 13

F. The Council's Investigation and Order . 15

G. The State Court Proceedings 19

H. The Federal Court Proceedings Before and After NOPSI III 22

Summary of Argument 25

TABLE OF CONTENTS
(continued)

Argument. 27

I. NOPSI'S OVERLY BROAD INTERPRETATION OF THE FEDERAL POWER ACT IS INCORRECT. 27

A. The Council's Authority Here is Fully Supported By Statutory Interpretation Based Upon the Plain Meaning of the Federal Power Act. 29

B. The Council's Authority is Also Supported by the Legislative Purpose, Background, and History of the Federal Power Act. 34

C. NOPSI's Expansive Reading of the Federal Power Act Disregards Critical Federalism Concerns . . . 38

1. Proper Statutory Interpretation Requires Taking Account of Federalism Concerns. 39

2. The Constitutional Plan Places Constraints Upon Federal Interference With State Authority. . . 43

D. Adopting NOPSI's Interpretation Would Produce Adverse Impacts Upon Consumers. 51

TABLE OF CONTENTS
(continued)

II. THE FIFTH CIRCUIT CORRECTLY APPLIED THE SUBTLETIES OF PREEMPTION DOCTRINES TO THIS CASE 56

A. Congress Has Not Explicitly Preempted the Field of Utility Regulation 59

B. There Is No Implicit Preemption of the Field of Utility Regulation. . . . 64

C. There is No Actual Conflict Between the Actions of FERC and the Council's Investigation and Order 68

1. The Council's Order is Not Inconsistent With FERC's Allocation 69

2. Neither Nantahala Nor MP&L Control This Factually Distinct Case 72

TABLE OF CONTENTS
(continued)

III. THE STATE COURT PROCEEDING IS THE PROPER FORUM FOR NOPSI'S CLAIMS, PARTICULARLY THE "PRETEXT" CLAIM. 84

A. The Federal Full Faith and Credit Statute Required the Federal District Court to Stay This Case 86

1. Final Judgment . . . 89

2. Identity of the Parties. 91

3. Identity of Cause. . 93

4. Identity of the Thing Demanded 95

B. Even if This Court Does Not Apply § 1738, the "Pretext" Claim Should Not be Considered Without a Complete Record. 97

Conclusion. 98

TABLE OF AUTHORITIES

Cases — Page

Allen v. McCurry,
449 U.S. 90 (1980) 87

Alliance for Affordable Energy v. New Orleans,
578 So.2d 949 (La. App. 4th Cir. 1991), pet. for cert. filed, No. 91 C 1475 (La. June 24, 1991) . . . . . 3,6,7, passim

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453 U.S. 571 (1981). 33,68

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319 U.S. 315 (1943). 14

Buuck v. Fos,
84 So.2d 186 (La. 1955). 91

California v. ARC Am. Corp.,
490 U.S. 93 (1989) 42

Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of New York,
447 U.S. 557 (1980). 30

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875 F.2d 903 (D.C.Cir.1989), cert. denied sub nom. Mississippi v. FERC, 110 S.Ct. 1805, 108 L.Ed.2d 936 (1990) . . 13

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(continued)

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486 U.S. 57 (1986) 48,58

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424 U.S. 800 (1976). 23

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324 U.S. 515 (1945). . . . 32,36,43

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447 So.2d 1208 (La. App. 5th Cir. 1984) 96

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456 U.S. 742 (1981). . . . 49,50,68

Fidelity Fed. Sav. & Loan Ass'n v. De La Cuesta,
458 U.S. 141 (1982). 64

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521 So.2d 488 (La. App. 4th Cir.), writ denied, 522 So.2d 570 (La. 1988) 92

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111 S.Ct. 403 (1990) 60

Garcia v. San Antonio Metrop. Transit Auth.,
469 U.S. 528 (1985). 44,48

Cases — Page

Jensen Constr. Co. v. Dep't of Transp. & Dev., 542 So.2d 168 (La. App. 1st Cir. 1989) 88,95,96

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Cases — Page

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Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953 (1986). . . . 22,76,77

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NOPSI v. The Council of the City of New Orleans, 111 S.Ct. 1617, 113 L.Ed.2d 715 (1991) 25

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Cases — Page

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Papas v. Upjohn Co., 926 F.2d 1019 (11th Cir. 1991) . 61

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Ward v. Pennington, 523 So.2d 1286 (La. 1988). . . . 90

Welch v. Crown Zellerbach Corp., 359 So.2d 154 (La. 1978) 91

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Younger v. Harris, 401 U.S. 37 (1971) 15

Statutes — Page

ERISA, 29 U.S.C. § 1144(a) 60

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Natural Gas Act,
15 U.S.C. 717 32

Federal Power Act,
16 U.S.C. § 824 2,31,32
passim

28 U.S.C. 1738 27,86

La. Rev. Stat. Ann.
§ 13:4231 (West 1991) 88

La. Rev. Stat. Ann.
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La. Rev. Stat. Ann.
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New Orleans Home Rule
Charter § 4-1604. 2

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Page

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19 URB. LAW. 523 (1987) 48

E. CHEMERINSKY, FEDERAL
JURISDICTION (1989) 87

Clinton, et al., FERC, State
Regulators and Public Utilities:
A Tilted Balance, 2 NAT. RESOURCES
ENV'T. 11 (Spring, 1987) . . . 35,52

Gelfand, The Constitutional
Position of American Local
Government,
14 HASTINGS CONST'L L.Q.
635 (1987). 48

Gelfand and Werhan, Federalism
and Separation of Powers on a
"Conservative Court,"
64 TUL.L.REV. 1443 (1990) 46

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Values of Federalism,
19 GA.L.REV. 789 (1985) 48

TABLE OF AUTHORITIES
(continued)

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H.R. Rep. No. 1318, 74th Cong., 1st Sess. (1935)	37
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CITATION OF OPINIONS

The opinion below is reported at NOPSI v. The Council of the City of New Orleans, 911 F.2d 993 (5th Cir. 1990). On February 8, 1991, the Fifth Circuit issued a correction to the opinion it had issued on August 29, 1990. Specifically, the Fifth Circuit withdrew incorrect language stating that the Council, after its extensive investigation, allowed 9% of Grand Gulf in NOPSI's retail rates. Instead, the corrected opinion reported that the percentage allowed in rates by the Council amounted to 14%. See Joint Appendix 16 (corrected version). (This correction makes clear that the percentage allowed by the Council's Order was different from the percentage they had sought before FERC.)

COUNTERSTATEMENT OF THE CASE

A. The Parties

Under Louisiana law, Respondent City Council for the City of New Orleans ["Council"] is the local ratemaking body with final authority over the retail rates charged by local electric and gas utilities. NOPSI v. The Council of the City of New Orleans, 911 F.2d 993, 997 (5th Cir. 1990); Joint Appendix ["J.A."] 11, at 15. See 16 U.S.C. § 824(b); La. Rev. Stat. Ann. §§ 33:4405, 33:4495 (West 1988). See also New Orleans Home Rule Charter § 4-1604.

Petitioner New Orleans Public Service, Inc. ["NOPSI"] is a producer, wholesaler, and retailer of electricity. It provides retail electricity to the City of New Orleans, except for the neighborhood of Algiers, which is served by Louisiana Power and Light ["LP&L"].

Alliance for Affordable Energy v. New Orleans, 578 So.2d 949, 953 (La. App. 4th Cir. 1991), pet. for cert. filed, No. 91 C 1475 (La. June 24, 1991). NOPSI, LP&L, Arkansas Power and Light ["AP&L"], and Mississippi Power and Light ["MP&L"] are wholly owned operating subsidiaries of Entergy Corporation (formerly known as Middle South Utilities ["MSU"]). J.A. 12. MSU operated an integrated "power pool" in which NOPSI and its sister power companies transmit the electricity they produce to a central dispatch center. Each company then draws back the power it needs to meet demand. NOPSI v. The Council of the City of New Orleans, 491 U.S. 350, 353 (1989) ["NOPSI III"].

The Alliance for Affordable Energy ["Alliance"] and Citizens for Safe Energy, Inc. ["SAFE"] are Louisiana non-

profit corporations. They are dedicated to protecting the public interest and ensuring fair and affordable utility practices locally and regionally. The Alliance was founded in 1985 and has approximately 450 members. The Alliance serves Louisiana's 1,700,000 gas and electricity ratepayers through educational programs promoting energy efficiency and citizen participation in decision-making processes. The Alliance also acts as a non-partisan watchdog monitoring the political, financial, technical, and environmental complexities of utility services in the region. SAFE, incorporated in 1982, is concerned primarily with energy-related environmental and consumer issues. Gary L. Groesch is a ratepayer of NOPSI, receiving electrical service in the City of New Orleans. [Hereinafter, the

Alliance, SAFE and Groesch are referred to collectively as "Alliance, et al."]

B. Historical Background -- The Costs of Grand Gulf

During the 1950s and 1960s, most of the generating plants in the MSU system were fueled by oil or natural gas. J.A. 13. In the late 1960s, MSU projected an increase in demand. MSU said it sought to meet that projected demand by constructing coal and nuclear generating plants, to diversify MSU's power supply portfolio. "[MP&L] was charged with constructing two plants at Port Gibson, Mississippi, to be known as Grand Gulf 1 and 2." NOPSI, 911 F.2d at 995. The Grand Gulf project, however, quickly proved too burdensome for one company to develop. MSU created yet another subsidiary, Middle South Energy, Inc. ["MSE"] (now known as Systems Energy

Resources, Inc., or "SERI"), which would "finance, own, and operate the Grand Gulf plants." Id. (The Board of Directors of SERI is composed of the presidents of the Entergy operating companies and the president of Entergy. Alliance, 578 So.2d at 954 n.2. Thus, the president of NOPSI has one vote on the SERI Board.) SERI owns 90% of Grand Gulf 1, while another, non-affiliated utility owns the other 10%. Technical services are provided by still another MSU subsidiary, Middle South Services, Inc. (MSS). NOPSI, 911 F.2d at 995-96.

In 1974, MSE contracted with these operating subsidiaries to finance the Grand Gulf project. J.A. 13. "The companies agreed to pay for the construction of the plants in exchange for the right to their output." Id. At that time, construction costs for both

plants were estimated at $1.2 billion. As the project progressed, consumer demand for electric power proved to be much lower than MSU and the power companies had projected. Regulatory delays, enhanced construction and safety requirements resulting from the Three Mile Island disaster, and high inflation rates led to spiraling costs on the Grand Gulf project. As a result, MSE suspended construction of Grand Gulf 2, but it continued to build Grand Gulf 1. Id.

When Grand Gulf 1 finally became operational in July 1985, the construction costs totalled approximately $3.65 billion, or roughly $3 billion more than the original estimate of $600 to $800 million for that plant. The cost overruns amount to an increase of 450% to 600%. Alliance,

578 So.2d at 955 n.3.

C. NOPSI'S Grand Gulf Costs

In late 1979, before Grand Gulf 1 became operational and before its ultimate cost was known, NOPSI applied to the Council for a "capacity adjustment clause" which would have authorized an automatic "pass-through" to New Orleans ratepayers of NOPSI's share of all future Grand Gulf construction costs. Id. at 995.

In January 1980 -- nine months after the Three Mile Island accident, but before the Council had acted on NOPSI's pass-through application -- NOPSI management undertook a voluntary commitment to purchase a 29.8% share of Grand Gulf power from MSE. It undertook this commitment even though its actual consumption need was only 9%. Id. NOPSI did not inform the Council of its

commitment to the Grand Gulf project until May, 1980, when it applied to pass-through those costs to the ratepayers.

After conducting hearings on NOPSI's application in May and September 1980, the Council declined to adopt the capacity adjustment clause. Id.

In 1982, MSU filed a Unit Power Sales Agreement with the Federal Energy Regulatory Commission ["FERC"]. The Agreement allocated shares of the output of Grand Gulf 1, and required each of MSU's subsidiary operating companies to pay for the shares specified. These payments were to cover construction costs of the plant. Under the agreement AP&L was not obligated to purchase any Grand Gulf power. J.A. 13-14. LP&L, which had not completed its plant, was obligated to purchase 38.57%; MP&L was

obligated to purchase 31.63%; and NOPSI was obligated to purchase 29.8%. Id. at 14. MSU also filed a new System Agreement with FERC, which set forth the terms and conditions for coordinated operations and wholesale transactions among these four companies, but did not deal with the Grand Gulf costs. Id.

D. FERC Proceedings

FERC assigned the agreements to two separate Administrative Law Judges ["ALJs"] for the statutorily required task of determining whether they were just and reasonable. Both judges held that the failure to distribute the Grand Gulf costs among all members of the power pool rendered the agreements unduly discriminatory; ALJ Head further held that these costs should be allocated in proportion to each company's relative system demand.

Middle South Services, Inc., 30 F.E.R.C. ¶ 63,030, pp. 65,170-65, 173 (1985) (ALJ Head) (System Agreement); Middle South Energy, Inc., 26 F.E.R.C. ¶ 63,044, pp. 65,105-08 (1984) (ALJ Liebman) (Unit Power Sales Agreement).

FERC consolidated the proceedings for review, and, on that review, determined that an adjustment of the shares allocated in the Unit Power Sales Agreement was necessary in order to render both agreements just and reasonable among the four companies. FERC reduced NOPSI's share of Grand Gulf costs from 29.8% to 17%. The New Orleans City Council had argued for a 9% share for NOPSI. J.A. 14. (See "Citation of Opinions" section, above.)

FERC found that Grand Gulf 1 had been planned, constructed, and completed to meet the needs of the MSU System "as

a whole." See Mississippi Power & Light Co. v. Mississippi ex rel. Moore, 487 U.S. 354, 362-63 (1988); Middle South Energy, Inc., 31 F.E.R.C. ¶ 61,305, (1985). FERC further found that this was part of a "reasonable" system plan to diversify power sources, so it established rates allowing MSE to recoup 100% of its Grand Gulf costs from the power companies. FERC determined that the four companies should take shares of the System's total nuclear power in proportion to their relative demand for all forms of energy generated by the system. MP&L, 487 U.S. at 364. As NOPSI's demand was 9% of the total system demand, FERC required it to bear 9% of the System's total nuclear power costs. But because NOPSI had no nuclear plant of its own, FERC required it to bear 17% of the Grand Gulf costs (to

cover 9% of the total nuclear power costs). J.A. 15 n.3.

The U.S. Court of Appeals for the D.C. Circuit ordered FERC to reconsider the allocations. Mississippi Indust. v. FERC, 808 F.2d 1525, modified on rehearing, 822 F.2d 1104 (D.C.Cir.), cert. denied, 484 U.S. 985 (1987). On reconsideration, FERC reaffirmed its original allocations. The D.C. Circuit then affirmed that decision. City of New Orleans v. FERC, 875 F.2d 903 (D.C. Cir. 1989), cert. denied sub nom. Mississippi v. FERC, 110 S.Ct. 1805 (1990).

E. The NOPSI I Case

After Grand Gulf became operational in July 1985, NOPSI filed another application with the Council to recover its construction and operating costs from the ratepayers. If granted, that

application would have resulted in an immediate 60% increase in retail utility rates. Alliance, 578 So.2d at 955. Though the Council denied an immediate rate increase, it offered NOPSI interim rate relief. NOPSI rejected this offer and filed suit in the U.S. District Court for the Eastern District of Louisiana against the City, its mayor, and members of the City Council (collectively and individually). Id. The district court dismissed that suit, holding that under the Johnson Act, 28 U.S.C. § 1342, it lacked jurisdiction to proceed. The court further ruled that even if it did have jurisdiction, it would be required by Burford v. Sun Oil Co., 319 U.S. 315 (1943), to abstain. The U.S. Court of Appeals for the Fifth Circuit reversed, but then withdrew its original opinion and, instead, affirmed

on rehearing, finding that abstention was proper under both Burford and Younger v. Harris, 401 U.S. 37 (1971). See NOPSI v. The City of New Orleans, 782 F.2d 1236, modified on rehearing, 798 F.2d 858 (5th Cir. 1986), cert. denied, 481 U.S. 1023 (1987) ["NOPSI I"].

F. The Council's Investigation and Order

On October 10, 1985, the Council passed Resolution R-85-636 undertaking an investigation into the prudence of NOPSI's participation in the Grand Gulf project and the resulting costs incurred, as well as NOPSI's efforts to minimize such costs. Alliance, 578 So.2d at 955. The resolution specifically provided that, in determining the appropriate retail rate increase, the Council would not seek to

invalidate any of the agreements surrounding Grand Gulf 1 nor would it order NOPSI to pay MSE a wholesale rate other than the rate approved by FERC. J.A. 16; NOPSI III, 491 U.S. at 356.

NOPSI responded to that Resolution by filing, in federal district court, a second suit which sought to enjoin the Council from holding the hearings. The district court dismissed on grounds of ripeness, and, in the alternative, abstained. Alliance, 578 So.2d at 955. The Fifth Circuit affirmed on the ground of lack of ripeness. NOPSI v. The Council of the City of New Orleans, 833 F.2d 583 (5th Cir. 1987) ["NOPSI II"]. Therefore, the Council's hearings were allowed to proceed.

"In March 1986, the Council entered into a partial settlement with NOPSI under which NOPSI agreed to absorb $51.2

million of the Grand Gulf costs, and the Council allowed NOPSI to phase in an interim rate increase, subject to the results of the Council's prudence investigation." Alliance, 578 So.2d at 955.

"The Council held hearings on the question of prudence from March 4, 1986, through February 24, 1987. In addition, the Council accepted into the record of that hearing written testimony, depositions, and reports prepared by expert witnesses. In April 1987, the Council completed the record of its investigation and began deliberations, which NOPSI attempted to prevent by seeking an injunction from the federal district court. This request was later dropped by NOPSI." Id.

After the Council completed its extensive investigation, it issued a

final Rate Order on February 4, 1988. J.A. 16; NOPSI III, 491 U.S. at 356. The investigation concluded that, at a minimum, NOPSI was imprudent in incurring approximately 30% (about $476 million) of Grand Gulf's $1.567 billion total costs for New Orleans, and that it had done virtually nothing to assess or minimize its risks. Id. The Rate Order found "that NOPSI's management failed to protect the interests of its ratepayers, and the company's conduct fell short of prudent utility management, to the detriment of its ratepayers and shareholders." Alliance, 578 So.2d at 956.

Fearing that disallowance of the entire amount would force NOPSI into insolvency, the Council made a one-time imprudence deduction of $150 million, which, on the basis of still further

caution, it reduced to $135 million. As a result, $186.2 million of the imprudently incurred Grand Gulf costs were disallowed (the $135 million disallowed by the Council's Order plus the $51.2 covered by the partial settlement). Thus, the Order allowed the remainder of these imprudently incurred costs (approximately $290 million) to be passed on to the ratepayers.

G. The State Court Proceedings

NOPSI then filed complaints against the Rate Order in both state and federal court. J.A. 16. In Louisiana's Civil District Court for the Parish of Orleans, NOPSI's case was consolidated with two previously filed suits: one filed by the Council seeking a declaratory judgment on the validity of its Rate Order, and one by consumer

advocates (the instant Respondents -- the Alliance, SAFE, and Groesch). The Alliance's suit challenged the Council's decision to disallow only $135 million of the total of $476 million in costs the Council had found to be imprudently incurred. Alliance, 578 So.2d at 956.

The Civil District Court upheld the Council's Rate Order, affirmed its validity, and denied the petitions of both NOPSI and the Alliance. That court "held that the rate order's findings were not preempted by federal law, and that its disallowance of imprudent costs was just and reasonable and supported by substantial evidence." Id.

The Louisiana Court of Appeal for the Fourth Circuit affirmed the Civil District Court's opinion insofar as it upheld the validity of the Council's prudence investigation and Order, noting

"[w]e find not only that substantial evidence in the record shows that NOPSI acted imprudently, but that the preponderance of the evidence would support the same conclusion." Id. at 964. Further, the Fourth Circuit found "there is no basis in law for the use of a balancing test [between ratepayers' and a utility's interests] in a case where costs have been found to be imprudent." Id. at 971. Thus, that court ruled that the Council had exceeded its authority when it allowed NOPSI to pass through imprudent costs to innocent ratepayers. The court held that the pass-through to ratepayers of imprudently incurred costs "would be in violation of the ratepayers' constitutional rights to property and due process of law under the Louisiana Constitution, Art. I, Sections 2 and 4,

and the U.S. Constitution, Amendments 5 and 14." Id. at 973.

H. The Federal Court Proceedings Before and After NOPSI III

In its suit in the U.S. District Court for the Eastern District of Louisiana, NOPSI argued that the Council could not prevent the pass-through of any Grand Gulf costs because the Council's investigation and Order were preempted by federal law under Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953 (1986). J.A. 16-17. The district court abstained under Burford and Younger, and the Fifth Circuit affirmed the district court's dismissal on abstention grounds. J.A. 17. NOPSI v. Council of New Orleans, 850 F.2d 1069 (5th Cir. 1988).

This Court then reversed, finding abstention improper on both grounds, but

holding that the Council's actions were not preempted by federal law. NOPSI III, 491 U.S. 350 (1989).

On remand, NOPSI again argued in the district court that the Council's Order was facially preempted and that the Council was attacking the FERC allocation. J.A. 17. The federal district court held that the Council's Order was not "facially" preempted, and stayed the so called "pretext" claim because the Louisiana trial court had already issued a judgment in favor of the Council on that issue. Id. (The Louisiana Civil District Court had held that the Council's Order was supported by substantial evidence. Id. See p. 20, above.)

The federal district court stayed further proceedings, based upon Colorado River Water Conservation Dist. v. United

States, 424 U.S. 800 (1976), and Moses H. Cone Memorial Hosp. v. Mercury Const. Corp., 460 U.S. 1 (1983). The Fifth Circuit affirmed.

Relying upon NOPSI III, the Fifth Circuit affirmed the district court's determination that the Council's Rate Order was not facially preempted by the FERC allocation. NOPSI v. The Council of the City of New Orleans, 911 F.2d 993, 995 (5th Cir. 1990) (Higginbotham, J., joined by Wisdom and Duhe', JJ.). The Fifth Circuit also found that the judgment rendered in the parallel state proceeding "weighs in favor of a stay" of NOPSI's "pretext" claim. Id. at 1005. Therefore, the Court ruled that the district court had not abused its discretion in deferring to the state courts on that claim. The Fifth Circuit concluded: "[f]inding no merit in

NOPSI's facial preemption challenge and that the district court properly stayed the pretext challenge, we affirm." Id. at 1005-06.

This Court granted NOPSI's writ of certiorari on April 22, 1991. NOPSI v. The Council of the City of New Orleans, 111 S.Ct. 1617, 113 L.Ed.2d 715 (1991).

SUMMARY OF ARGUMENT

Petitioner NOPSI and Amicus FERC have sought to interpret federal administrative authority under the Federal Power Act ["FPA"] too broadly. Their interpretation substantially exceeds Congressional intent, as shown by the plain meaning of the key statutory language and by the legislative background and history of that language. Indeed, their extreme interpretation goes so far as to raise

constitutional problems which could be easily avoided by a narrower, more reasonable interpretation. NOPSI's approach would also have detrimental policy implications for the federal system and for consumers.

NOPSI's preemption analysis is too simplistic. Other federal statutory schemes show that different regulatory tasks can be handled by different tiers of government. The focus should be on the nature of the regulation and type of decision involved. When that standard form of preemption analysis is adopted, it becomes clear that the Council's hearing and Order are not preempted explicitly, implicitly, or as a result of a direct conflict with federal power. Hence, both NOPSI's "facial" preemption claim and its preemption by "pretext" claim must fail.

This is not, in any event, the appropriate case to decide these issues. The courts below should have stayed this action out of deference to the state court judgment, pursuant to 28 U.S.C. § 1738 (full faith and credit statute) and Louisiana's lis pendens statute. NOPSI's claims have been litigated in the state court proceedings, on a fuller factual record, and the federal aspects of those state decisions can later be reviewed by this Court on petition for certiorari, if necessary.

ARGUMENT

I. NOPSI'S OVERLY BROAD INTERPRETATION OF THE FEDERAL POWER ACT IS INCORRECT.

The question presented to this Court is whether the Council, in setting retail rates, had authority to determine whether NOPSI acted imprudently in failing to diversify its power supply

portfolio and in failing even to investigate off-system sales of power after the Grand Gulf project was underway. Review of the language of the FPA, the background and history of that Act, and the general history of public utilities regulation demonstrate that the Council did have precisely this authority.

The question is not whether the New Orleans City Council had jurisdiction to determine the prudence of NOPSI's original decision to participate in the construction of Grand Gulf 1. Nor is it whether the Council had jurisdiction to determine what percentage of Grand Gulf's power output could be allocated to NOPSI. These questions, which have been previously resolved in favor of FERC, are merely straw men, and they shed little light on the question

actually pending before this Court.

The regulatory decisions rendered by the Council concerned the setting of appropriate retail rates, in light of NOPSI's deficient and negligent business practices. This type of decision is well within the Council's regulatory authority under the FPA.[1]

A. The Council's Authority Here is Fully Supported By Statutory Interpretation Based Upon the Plain Meaning of the Federal Power Act.

There can be little doubt that the regulation of the business practices of, and retail rates charged by, utilities has long been a traditional state function. In the prior round of this

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[1] Though the Fifth Circuit's description of the Council's decision in temporal terms, see 911 F.2d at 997-98, seems to have invited opposition by NOPSI, the proper focus should be on the nature of the regulation and type of decisions involved. See Part II.C.2, below.

very case, this Court stressed that Louisiana has a "substantial, legitimate interest in regulating intrastate rates," NOPSI v. The Council of the City of New Orleans, 491 U.S. 350, 365 (1989) [NOPSI III]. The Court then reaffirmed that "the regulation of utilities is one of the most important functions traditionally associated with the police power of the States." Id., quoting Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n, 461 U.S. 375, 377 (1983), and citing Pacific Gas & Electric Co. v. State Energy Resources Conservation & Dev. Comm'n, 461 U.S. 190, 205-06 (1983); Central Hudson Gas & Electric Corp. v. Public Serv. Comm'n of

New York, 447 U.S. 557, 569 (1980).[2]

In drafting the FPA, Congress directly protected this traditional state authority. The Act granted the Federal Power Commission ["FPC"] (now FERC) regulatory authority over certain specified aspects of the generation of electricity and "of that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce. . . ." 16 U.S.C. § 824(a) (1988) (emphasis added). See also 16 U.S.C. § 824(b)(1) (1988) (wholesale

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2 Indeed, this Court correctly noted that even "NOPSI does not deny that the State has an interest affirmatively protected by federal law in conducting proceedings to set intrastate retail electricity rates. . . ." NOPSI III, 491 U.S. at 366. Petitioner's objection is only to what it perceives to be the subject matter of these particular Council hearings.

sales in interstate commerce only).

The Act then specifies that "such Federal regulation, however, [is] to extend only to those matters which are not subject to regulation by the States." Id. (emphasis added). See also 16 U.S.C. § 824(b)(1) (1988) (denying FERC jurisdiction, inter alia, over "facilities used in local distribution or only for the transmission of electrical energy in intrastate commerce"). Congress thereby accepted the substantial tradition of state (and local) regulation of retail sales of energy. See Connecticut Light & Power Co. v. Federal Power Comm'n, 324 U.S. 515, 524-27 (1945).

Similarly, the Natural Gas Act ["NGA"], which employs parallel language (15 U.S.C. § 717(b) (1988)), was designed not to eviscerate state

authority, but rather to aid state regulation. See Panhandle E. Pipe Line Co. v. Public Serv. Comm'n, 332 U.S. 507, 517, 520-21 (1947). See generally Arkansas La. Gas Co. v. Hall, 453 U.S. 571, 577 n.7 (1981) (noting similarity of FPA and NGA for analytic purposes).

Thus, the plain meaning of the Act restricts federal regulation to wholesale sales in interstate commerce, while preserving state authority over intrastate sales. When applied to this case, the FPA mandates federal regulation of wholesale purchases among the MSU power pool members, but Council jurisdiction over the retail implications of NOPSI's potential off-system sales and diversification of its power supply portfolio.

B. The Council's Authority is Also Supported by the Legislative Purpose, Background, and History of the Federal Power Act.

The well-known background to the FPA makes it clear that Congress was not seeking to unleash the federal regulatory giant that NOPSI and FERC urge this Court to create.

The FPA emerged in the wake of Public Util. Comm'n of Rhode Island v. Attleboro Steam & Elec. Co., 273 U.S. 83 (1927). There, the State Commission attempted to regulate the rates at which a local utility could sell electricity wholesale to an out-of-state distributor. This Court "struck down that regulation, holding that, because it involved a transaction at wholesale, it imposed a 'direct' rather than 'indirect' burden on interstate commerce." Arkansas Elec. Coop., 461

U.S. at 378.

"Congress interpreted [Attleboro] as prohibiting state control of wholesale rates in interstate commerce for resale, and so armed the Federal Power Commission with precisely that power." United States v. Public Util. Comm'n of California, 345 U.S. 295, 308 (1953) (emphasis added) (footnote omitted). Thus, Congress enacted the FPA with the intention of "filling the [regulatory] gap" created by Attleboro with respect to interstate wholesale rates. Arkansas Elec. Coop., 461 U.S. at 378-80. See generally Clinton, et al., FERC, State Regulators and Public Utilities: A Tilted Balance, 2 NAT. RESOURCES & ENV'T. (Spring, 1987).

Given this background to the FPA, it is not surprising that Congress included in § 201 of the Act (now

Sections 824(a) and 824(b)(1) of Title 16) a specific reservation of state regulatory authority over all other aspects of the regulatory process.

Indeed, Justice Jackson's detailed review of the history and background of the FPA, in Connecticut Light & Power Co. v. FPC, 324 U.S. 515, 525-27, 529 (1945), revealed a "constant purpose to protect rather than to supervise authority of the States." See also S.Rep. No. 621, 74th Cong., 1st Sess. 48 (1935) (Subsection (a) "declares the policy of Congress to extend that [federal] regulation to those matters which cannot be regulated by the States . . . but not to impair or diminish the powers of any State commission."); id. at 18 (limitations upon federal commission's jurisdiction in each section in order to prevent

"encroachment" upon state authority); H.R. Rep. No. 1318, 74th Cong., 1st Sess. 27 (1935) ("As in the Senate bill no jurisdiction is given over local distribution of electric energy, and the authority of States to fix local rates is not disturbed even in those cases where the energy is brought in from another State."); id. at 8 ("Probably, no bill in recent years has so recognized the responsibilities of State regulatory commissions as does title II of this bill.")[3]

The limiting statutory language throughout the FPA gives FERC jurisdiction only over wholesale prices. As a result of recent cases, see Part II.C.2, below, this Court has allowed

[3] Brief of Respondents the Council of the City of New Orleans ["Council's Brief"] at Part II discusses similar passages from the legislative history of the FPA and related federal statutes.

FERC to reach the outer perimeter of its potential jurisdictional authority under the FPA. Yet, in this case, NOPSI contends that FERC should have exclusive jurisdiction over all of NOPSI's prices, including even off-system sales and the rates paid by intrastate retail consumers. The line must be drawn here; this mushrooming of federal power should not be allowed to continue.

C. NOPSI's Expansive Reading of the Federal Power Act Disregards Critical Federalism Concerns.

A fully functioning federal system requires that States continue to play crucial roles, as politically accountable service providers and regulators. But NOPSI's overly broad interpretation of FERC's jurisdiction would undercut these basic federalism concerns, by allowing an unelected

federal agency to dictate both wholesale and retail rates for any utility involved in an interstate power pooling arrangement. See Petitioner's Brief ["NOPSI Brief"] at 24-25. See also Brief for the United States and the Federal Energy Regulatory Commission as Amicus Curiae Supporting Petitioner ["FERC Brief"] at 14; Brief of Edison Institute as Amicus in Support of Petitioner at 8.

1. Proper Statutory Interpretation Requires Taking Account of Federalism Concerns.

A statutory scheme involving cooperative federalism, such as the system developed under the FPA, not only defines federal regulatory power over national concerns but also confines that federal jurisdiction, and maintains a key role for state regulators and

consumers. As explained above, the plain meaning of the FPA's statutory language, the background to the Act, and its legislative history demonstrate a Congressional intent to protect the traditional and historic state regulation of utilities. See Parts I.A and B, above.

Of course, judicial interpretation must draw lines defining the federal and state regulatory spheres. Those lines should be drawn based upon the type of regulation and nature of the regulatory decision involved. For example, in Attleboro, this Court drew the line between state regulation of retail rates and federal regulation of wholesale rates. The FPA, enacted in response to Attleboro, was intended to give FERC only limited jurisdiction over interstate aspects of public utilities,

while preserving for the States their traditional regulatory functions. See Part I.B, above. Though modern developments, such as power-pooling arrangements, do present some complexities, none of them require abandonment of the States' key role under our federalism. See generally Pacific Gas & Elec. Co. v. State Energy Resources Conserv. & Dev. Comm'n, 461 U.S. 190 (1983).

In the instant case, NOPSI and its supporting Amici would have this Court take several uncharted steps beyond the current cases, by imposing exclusive federal jurisdiction to insulate all of NOPSI's management decisions, merely because NOPSI is involved in an interstate power-pooling arrangement. If NOPSI's theory of FERC's all-encompassing authority were accepted by

this Court, it would severely undercut essential principles of federalism (to the point of raising constitutional questions that can otherwise be avoided, see Part I.C.2, below). As Congress has not directly and explicitly manifested an intent to eviscerate this basic state power, a narrow reading of the FPA's plain terms is required, rather than FERC's or NOPSI's expansive exegesis. See NOPSI, 911 F.2d at 1002, citing California v. ARC Am. Corp., 490 U.S. 93 (1989), and Rice v. Santa Fe Elevator Corp., 331 U.S. 218 (1947).

In interpreting the federalism concerns contained in the FPA, Justice Jackson explained:

> Congress is acutely aware of the existence and vitality of these state governments. . . . Congress may think complete centralization of control of the electric industry likely to overtax administrative capacity of a federal commission.

> It may, too, think it wise to keep the hand of state regulatory bodies in this business, for the "insulated chambers of the states" are still laboratories where many lessons in regulation may be learned. . . .

Connecticut Light & Power, 324 U.S. at 530. These federalism concerns should continue to inform this Court's statutory interpretation of the FPA, even in these days of interstate power pools.

2. The Constitutional Plan Places Constraints Upon Federal Interference With State Authority.

Under our federal system, the "Constitutional Plan," protects State sovereignty against inappropriate forms of interference by the federal government. See generally Nevada v. Hall, 440 U.S. 410, 433 (1979) (Rehnquist, J., dissenting); L. TRIBE, AMERICAN CONSTITUTIONAL LAW 381-82 (2d ed. 1988). The extent to which these

constitutional protections are judicially enforceable against assertions of federal agency power presents a difficult constitutional question. That difficult issue need not be confronted here, if a reasonable interpretation is given to the FPA -- one which takes account of its language, background, and history, and, which properly weighs state interest in the analysis.[4] See Parts I.A through C.1, above. However, if this Court takes NOPSI's expansive theory of FERC's exclusive jurisdiction seriously, then it should also ask whether Garcia v. San Antonio Metrop. Transit Auth., 469 U.S.

[4] This defense, based upon the judicially enforceable constitutional barrier protecting States against the inappropriate expansion of federal power, was not directly raised in the District Court or the Court of Appeals, as neither of those courts accepted the overly broad interpretation of FERC's jurisdiction now being pressed by NOPSI.

528 (1985), needs to be limited or overruled.

In Garcia, a bare majority of this Court rejected a claim that the Tenth Amendment protected state and local governments from compliance with the same provisions of the Fair Labor Standards Act that were applicable to private employers. A central premise of that decision was that "State sovereign interests, then, are more properly protected by procedural safeguards inherent in the structure of the federal system than by judicially created limitations of federal power." Id. at 552. That point was supported by reference to the consistent Congressional solicitude toward state interests: "For example, the Federal Power Act, the National Labor Relations Act, . . . [and several other federal

statutes] all contain express or implied exemptions for States and their subdivisions." Id. at 553 (emphasis added) (footnote omitted).

A majority of the Court concluded that judicially enforceable constraints upon federal interference with the modus operandi of state and local governments was not necessary on the facts of Garcia, see 469 U.S. at 556.[5] However, NOPSI's approach to this case presents the issue more sharply and directly.

In the instant case, the elected City Council conducted a prudence investigation prior to approving retail utility rates -- precisely the authority

5 Nor did the tax statute in South Carolina v. Baker, 485 U.S. 505 (1988), or the spending condition in South Dakota v. Dole, 483 U.S. 203 (1987), require this Court to confront this difficult issue. See generally, Gelfand & Werhan, Federalism and Separation of Powers on a "Conservative Court", 64 TUL.L.REV., 1443, 1451-53, 1456 (1990).

reserved to such a state-authorized regulator. The Council based its decision upon NOPSI management's "ostrich" policy, which failed to deal realistically with, or even to recognize, skyrocketing costs. J.A. 171-72.

On the other hand, Amicus FERC, a federally appointed agency, here seeks to exceed its Congressionally granted authority, by insulating NOPSI from that local review of its imprudent and deficient management practices. Moreover, FERC never asserted jurisdiction over the subject matter of the Council's prudence hearing until this, the second Supreme Court stage of

this long-running case.[6] Under these circumstances, the "procedural safeguards" of the Congressional process referred to in Garcia[7] can hardly be

[6] See generally Council's Brief at Part II.B.2. Neither FERC nor NOPSI can find solace in City of New York v. FCC, 486 U.S. 57, 60 (1988), as this Court specifically did not address whether the agency had gone beyond its statutory authority.

[7] Respondents the Alliance et al. respectfully point out that current members of this Court, see e.g., Garcia, 469 U.S. at 579 (Rehnquist, J., dissenting); id. at 580 (O'Connor, J., dissenting), and many commentators have questioned the broad scope of Garcia, especially where the federal regulation undercuts the political accountability or disrupts the modus operandi of state or local governments. See, e.g., TRIBE, supra at 378-400; WORKING GROUP ON FEDERALISM OF DOMESTIC POLICY COUNCIL, THE STATUS OF FEDERALISM IN AMERICA (Nov. 1986); Chapin, Reinvigorating Federalism, 19 URB. LAW. 523, 523-26 (1987); Gelfand, The Constitutional Position of American Local Government, 14 HASTINGS CONST'L L.Q. 635, 654-55 (1987); Howard, Garcia and the Values of Federalism, 19 GA. L.REV. 789 (1985); Stephenson & Levine, Vicarious Federalism, 19 URB. LAW. 683-88 (1987). See also Gelfand & Werhan, supra.

considered sufficient to protect State prerogatives against federal agency overreaching. See generally, NOPSI, 911 F.2d at 1002, quoting MP&L, 487 U.S. at 391 (Brennan, J., dissenting) (fearing that States will be divested "of authority to determine the prudence of costs incurred by retail utilities whenever those utilities belong to an interstate power pool"). See also FERC v. Mississippi, 456 U.S. 742, 777 (1981) (O'Connor, J., dissenting) (warning against "harness[ing] state power for national purposes").

In setting retail rates, the Council must take FERC-approved wholesale costs as a given cost-component, but the Council still must have the power to consider how NOPSI management deals with the risks associated with these and other costs.

NOPSI and similar investor-owned utilities have a state-granted monopoly; market forces do not operate to guide or direct their business affairs. The regulation of fair retail rates must be provided by the Council. Therefore, the state (or local) regulator has to be able to evaluate a local utility's deficient business decisions and failure to reduce economic risks. That crucial regulatory power should have constitutional protection. See FERC v. Mississippi, 456 U.S. at 781 (O'Connor, J., joined by Burger, C.J., and Rehnquist, J., dissenting) ("Utility regulation is a traditional function of state government, and the regulatory commission is the most integral part of that function.") (footnote omitted).

D. Adopting NOPSI's Interpretation Would Produce Adverse Impacts Upon Consumers.

Under NOPSI's misinterpretation of the FPA, utilities would be encouraged, if not forced, to join multistate holding companies in order to compete in a market in which intrastate utilities are carefully regulated by the States, while interstate utilities are regulated solely by a federal agency which, commentators contend, tends to favor the interests of utility stockholders over consumers.

According to a recent report of the National Regulatory Research Institute at Ohio State University, there are significant differences in the ratemaking policies and practices of FERC and state regulatory agencies in areas such as "earnings on assets not yet in service, treatment of plant

cancellation costs, treatment of excess generation capacity," and what it terms FERC's "lenient examination of the prudence of the seller of wholesale power." Clinton, et al., FERC, State Regulators and Public Utilities: A Tilted Balance, 2 NAT. RESOURCES & ENV'T 11 (Spring, 1987), quoting Pfeffer & Lindsay, The Narragansett Doctrine (1984). The States' role in protecting the local interest is essential to balancing the national interest in regulating commerce, and the local interest in protecting constituent consumers. Clinton, supra, at 45-46.

FERC approves agreements involving electric generation facilities a decade or more in advance of changes in retail rates. See NOPSI, 911 F.2d at 996-97 (describing FERC acceptance of the representations of MSU executives here).

According to NOPSI, those generation costs become the principal components of the utility's costs. NOPSI Brief at 25 n.27, and accompanying text. FERC also argues that state regulatory commissions, in setting retail rates, cannot even consider how the utility has managed these costs. FERC Brief at 11-12, 14-15. See also NOPSI Brief at 30-35. Hence, under these expansive theories, FERC's tentacles reach both forward and backward, throughout the regulatory process, precluding any state regulation of the rates of any utilities that are part of an interstate power pool. These misguided theories have foreclosed consumers from knowledgeable participation in the process, given the extended time-line involved.[8]

[8] Finally, NOPSI's expansive theory of FERC jurisdiction would lead to absurd practical results whenever a

But deficient business decisions, such as the total failure of NOPSI executives to pursue off-system sales and other methods of reducing economic risks, should not fall upon the ratepayers. The resulting costs should be borne by the shareholders of the utility, who should not be insulated from the consequences of negligent management through overly expansive theories of possible FERC jurisdiction. Alliance, 578 So.2d at 973.

Finally, it should be noted that Respondents the Alliance, et al., while supporting the crucial regulatory role of the Council, do not support all aspects of the Council's Ratemaking Order. In the instant case, as a result

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utility subject to a FERC order does sell power off-system. See Council's Brief at Part II.B.3 (providing illustrative examples).

of the Council's Order and a partial settlement, the ratepayers of New Orleans are shielded from only $186.2 million of costs found by the Council to be imprudent, but NOPSI has been allowed to recover $290 million of those imprudent costs.

"[B]oth law and public policy mandate that stockholders, not ratepayers, bear the burden of such costs." Id. at 969-74, and sources cited therein. Yet, the Council chose not to follow these well-established prudence principles, fearing that it could lead to corporate reorganization for NOPSI.

If the Council's reasoning held true in the general marketplace, "once the leadership of a business finds out that it cannot lose, it can no longer be held accountable for the reasonableness

of its decisions." The Alliance cannot accept such reasoning. Id. at 973 (quoting testimony of Dr. Jeffrey Barach). Dr. Barach also "suggested that the Council's decision to limit the amount of the disallowance would signal management 'that grossly imprudent acts are better than slightly imprudent acts'." Id.

II. THE FIFTH CIRCUIT CORRECTLY APPLIED THE SUBTLETIES OF PREEMPTION DOCTRINES TO THIS CASE.

NOPSI's broad and simplistic interpretation of preemption ignores the ability of the Congress and this Court to divide a regulatory task into its component parts. Such a division has been properly done here. Interstate sales of wholesale electricity and allocations of power from an interstate pool have been regulated by FERC. By

contrast, the prudence of retail and off-system sales have been reviewed by the State-authorized regulator, in this case, the New Orleans City Council. See generally NOPSI III, 491 U.S. at 352, 367. This distribution of authority best complies with the language of the FPA, its background and history, and the federalism concerns so critical to Congress and this Court. See Parts I.A-C, above.[9]

In analyzing preemption issues, this Court traditionally begins with the presumption that state authority is not preempted. Moreover, "a federal agency may preempt state law only when and if it is acting within the scope of its congressionally delegated authority."

[9] Even Justice Scalia's concurring opinion in MP&L, 487 U.S. at 383, oft-quoted by NOPSI and their Amici, speaks only to FERC's authority over electrical generation contracts and wholesaling.

Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 374 (1986). Thus, the "critical question in any preemption analysis is always whether Congress intended that federal regulation supersede state law." Id. at 369 (emphasis added).[10]

Congressional intent may be expressed explicitly in the federal statute, may be implicit (occupation of the field), or may arise from a conflict between federal and state regulations. See Wisconsin Pub. Intervenor v. Mortier, 111 S.Ct. 2476, 2482 (1991). None of those three forms of preemption

10 City of New York v. FCC, 486 U.S. 57 (1986), does not authorize an agency to exercise broad authority without a direct statutory empowerment. This Court decided City of New York solely on the basis of the provisions of the 1984 Cable Act. This Court specifically declined to determine the legitimacy of the FCC's cable television policies prior to the passage of that Act. Id. at 70 n.6.

is present in this case.

A. Congress Has Not Explicitly Preempted the Field of Utility Regulation.

The FPA does not expressly preempt state retail rate-making authority. Indeed, the statutory language, background, and legislative history of the FPA demonstrate that Congress was especially protective of the States' traditional power to regulate local utilities. See Parts I.A-C, above.

If Congress had intended to provide FERC with the expansive authority to regulate all stages of ratemaking -- retail as well as wholesale -- such authority would have been detailed in the FPA. Congress is perfectly capable of stating whether or not an Act is intended to supersede state authority. Congress is also capable of delineating the specific areas of state authority

that are to be superseded.

Here, the position taken by NOPSI and FERC simply fails to acknowledge that Congress often provides for separate areas of state and federal control. In fact, the extent to which federal statutes preempt state law can range from almost complete federal preemption of a field to a very narrowly defined scope of federal authority.

The Employee Retirement Income Security Act (ERISA) provides an example of Congressional intent to preempt state authority broadly. ERISA's preemption clause supersedes any state law relating to employee benefit plans. 29 U.S.C. § 1144(a). See FMC Corp. v. Holliday, 111 S.Ct. 403, 407 (1990).

At the other end of the spectrum are statutes, such as the Federal Insecticide, Fungicide, and Rodenticide

Act (FIFRA). 7 U.S.C. §§ 136, et seq. FIFRA's preemption of state authority extends only to state laws that regulate the labelling and packaging of pesticides. The statute very clearly leaves regulation of sales and use to the States. See Wisconsin Pub. Intervenor, 111 S.Ct. at 2486; Papas v. Upjohn Co., 926 F.2d 1019, 1023-24 (11th Cir. 1991).

The middle ground of the preemption spectrum is illustrated by statutes, such as the Communications Act, which expressly establish separate areas of regulation for federal and state agencies. In Louisiana Pub. Serv., this Court analyzed a direct conflict between state and federal regulations regarding the methods of depreciation to be used for certain telephone equipment. 476 U.S. at 358-59. See also Part II.C.1,

below. Despite the presence of that direct conflict, this Court found that Congress expressly intended to create a dual regulatory system, including possible "jurisdictional tensions." 476 U.S. at 375.

Similarly, in the Federal Power Act, Congress also plainly established such a dual regulatory system for electrical utilities -- federal regulation of wholesale interstate transactions, and State regulation of retail transactions. In the present case, the FPA plainly states that FERC has control only over wholesale rates for power sold in interstate commerce. NOPSI argues that the Council's retail Rate Order interfered with the FERC-approved wholesale rates.[11] NOPSI's

[11] NOPSI appears to make the claim of explicit preemption as part of its "facial preemption" argument, see NOPSI

argument can only be accepted, however, by misreading the FPA to say that FERC has regulatory authority over all stages of rate-making, from wholesale to retail, any time a utility is part of an interstate power pool arrangement. If Congress had intended to allow FERC to regulate and set intrastate retail rates, it could have expressed this intent in the FPA by simply adding the phrase "and retail" after all its references to "wholesale." Obviously, Congress did not do so, and as this Court "so often admonish[es], only Congress can rewrite this statute."

Brief at 37-45. But that claim has already been resolved against NOPSI both in this Court's prior decision, see NOPSI III, 491 U.S. at 363-64, and in the state proceedings, where NOPSI fully litigated the issue. See Part III.A, below. NOPSI simply seeks here a third bite of the well-gnawed apple. See Council's Brief at Part I.A. See also note 12, below.

Louisiana Pub. Serv., 476 U.S. at 376.

B. There Is No Implicit Preemption of the Field of Utility Regulation.

There is no basis for asserting that the federal government has occupied the field of electric utility regulation to the exclusion of State prudence investigations.

When Congress creates a regulatory agency and assigns it broad regulatory powers in a particular area, the grant may indicate a Congressional intent to preempt the field. Fidelity Fed. Sav. & Loan Ass'n v. De La Cuesta, 458 U.S. 141 (1982). Again, however, it is a matter of degree. Despite substantial federal occupation, the States still might be allowed to regulate certain aspects of the subject matter, if those aspects are found to be sufficiently local in nature.

For example, Congress regulates the nuclear power industry extensively, through the Nuclear Regulatory Commission [NRC]. The NRC was created for the express purpose of promoting and regulating nuclear energy production. In Pacific Gas & Elec. Co. v. State Energy Resources Conserv. and Dev. Comm'n, 461 U.S. 190 (1983), this Court considered a California law which conditioned the construction of any new nuclear power plants within the state upon findings by a State agency that California possessed adequate disposal facilities. Because the California statute addressed economic problems rather than the health and safety considerations encompassed by the federal scheme, this Court held that the state statute was not preempted. Id. at 220-23. Justice White's opinion for the

Court explained:

> Early on, it was decided that the States would continue their traditional role in the regulation of electricity production. The interrelationship of federal and state authority in the nuclear energy field has not been simple; the federal regulatory structure has been frequently amended to optimize that partnership.

Id. at 194. He added: "States exercise their traditional authority over the need for additional generating capacity, the type of generating facilities to be licensed, land use, ratemaking, and the like." Id. at 212 (emphasis added) (footnote omitted).

The Pacific Gas & Elec. Court further opined: "It is almost inconceivable that Congress would have left a regulatory vacuum; the only reasonable inference is that Congress intended the States to continue to make these judgments." Id. at 207-08

(emphasis added). In the instant case, a ruling that the Council's prudence investigation is preempted would create such an "inconceivable" regulatory vacuum. While a state prudence inquiry would be allowed with regard to non-affiliated utilities, no one would be able to conduct them for utilities involved in interstate power pools.

It is also clear that Congress did not intend to "occupy the entire field" of utility regulation when it enacted the FPA. Otherwise, Congress would not have specifically preserved the important, historically-based role for the States in the statutory language itself. See Parts I.A and C, above. Maintaining the delicate state-federal regulatory balance requires recognition of utility regulation as a traditionally important aspect of the state police

power. See NOPSI III, 491 U.S. at 365; FERC v. Mississippi, 456 U.S. 742, 781 (1981) (O'Connor, J., dissenting); Arkansas La. Gas Co. v. Hall, 453 U.S. 571, 577 n.7 (1981); Arkansas Elec. Coop., 461 U.S. at 377.

C. There is No Actual Conflict Between the Actions of FERC and the Council's Investigation and Order.

NOPSI's claim that the Council's prudence investigation and Order are preempted because they conflict with FERC orders is simply incorrect. Preemption through an actual conflict occurs when compliance by the regulated body with both statutes is impossible or, when the state and federal actions are found to have conflicting objectives.

1. The Council's Order Is Not Inconsistent With FERC's Allocation.

Even if the federal and state regulations do not conflict "upon their face" (where compliance with both is not possible),[12] the state law may be preempted because the Court finds that the objectives behind the two regulations are inconsistent. Transcontinental Gas Pipeline Corp. v. State Oil and Gas Bd. of Mississippi, 474 U.S. 409 (1986).

The Council's inquiry into whether NOPSI's negligence in failing to pursue the option of selling power off-the-system was not preempted, as it was sufficiently local in nature. The inquiry did not call into question the

[12] NOPSI's "facial preemption" challenge may fall into this category. If has, nonetheless, already been rejected. See note 11, above, and Part II.C.2, below.

federally approved allocation of power,[13] the amount of power that NOPSI was obligated to purchase, or the federally approved price of that power. Instead, the Council's inquiry focused upon NOPSI's total failure to investigate reducing the economic risks.

Under NOPSI's approach to this subject, once a FERC rate order has been issued (or even anticipated), members of interstate power pools would have no incentive to reduce risks or costs by changing their mix of power sources or selling power off-system. In the instant case, the economic risks were not even weighed, and the options available to NOPSI were not pursued,

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13 The Council fully conceded that NOPSI is obligated to purchase the federally approved allocation of power at the federally approved wholesale price. See Council Brief at Part II.B.1.

despite representations made by NOPSI's management, under oath, to the City Council.

NOPSI claims that the Council has never identified a "sucker" utility that would or could have purchased the excess capacity, see NOPSI Brief at 44, but this argument begs the crucial question. In retrospect, it may now be extremely difficult to determine the range of options for off-system sales at a point in time in the past. It is, however, disingenuous for NOPSI to blame the City (and burden its ratepayers) for this current difficulty. Because of their "ostrich" policy, NOPSI management failed to explore any of these off-system sales options, despite their repeated statements that such options were possible.[14] This information is,

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14 See the discussion in Part II.B.2,

and was, peculiarly within NOPSI's province and knowledge; NOPSI's management utterly failed to investigate the matter.

2. Neither Nantahala Nor MP&L Control This Factually Distinct Case.

Both FERC and NOPSI overread Mississippi Power & Light Co. v Mississippi ex rel. Moore, 487 U.S. 354 (1988), to arrive at the erroneous conclusion that no Council prudence investigation of any kind can be held, even though neither the type of investigation conducted by the New Orleans City Council nor its regulatory subject matter were before this Court in MP&L.

FERC and NOPSI arrive at their erroneous conclusion based upon the

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below, regarding NOPSI President Cain's representations to the Council.

"logic" of the rule in MP&L. FERC Brief at 15, 18, 20; NOPSI Brief at 28-34. Yet, they disregard the actual language in this Court's prior opinion in this case, see NOPSI Brief at 36. They apparently assume that this Court did not mean what it said when it stated that the Council's hearing not facially preempted by "the federal statute, the regulations implementing it, or the case law applying it." NOPSI III, 491 U.S. at 367.

The instant case is readily distinguishable from both Nantahala and MP&L. In fact, this Court has already correctly characterized the Council's Rate Order as follows:

> The Council has not sought directly to regulate wholesale rates; nor has it questioned the validity of the FERC-prescribed allocations of power within the Grand Gulf system, or the FERC-prescribed wholesale rates; nor has it reexamined the

> prudence of NOPSI's agreement to participate in Grand Gulf 1 in the first place. Rather, the Council maintains that it has examined the prudence of NOPSI's failure, after the risks of nuclear power became apparent, to diversify its supply portfolio, and that finding that failure negligent, it has taken the normal ratemaking steps of making NOPSI's shareholders rather than the ratepayers bear the consequences. Nothing in this is directly or even indirectly foreclosed by the federal statute, the regulations implementing it, or the case law applying it.

NOPSI III, 491 U.S. at 367. See also id. at 352.

On remand, the Fifth Circuit agreed with this characterization of the Council's Rate Order and found that the Order was not facially preempted, under either Nantahala or MP&L. That court reasoned that the Council's Order considered only those imprudent costs, incurred as a result of deficient NOPSI management, after NOPSI had entered into the Grand Gulf agreement. NOPSI, 911

F.2d at 1001.

The Fifth Circuit seemed to stress the sequence of the decisions, but the proper focus should not be on the time frame. (Though the state regulation often will come after the FERC order, it need no do so.) Instead, as this Court has noted, the proper focus for preemption analysis is on the type of decision or the nature of the regulation. See generally Arkansas Elec. Coop., 461 U.S. at 379-80.

As the Fifth Circuit correctly discerned, the only basis of challenge remaining has to be that the Council's action allegedly was a "pretext." Even assuming, however, that the "pretext" issue has been properly raised in this case, that issue involves only sufficiency of evidence -- an issue resolved against NOPSI in the parallel

state court proceedings. See Part III, below.

NOPSI attempts to bring the instant case within the broadest reach of this Court's fact-bound language in Nantahala and MP&L. Those cases hold that a state regulator, in setting retail rates for a utility which is part of an interstate power pool, must treat that utility's FERC-approved wholesale costs as a reasonably incurred operating expense. That is, such power costs become one given component when calculating an appropriate retail rate. See Nantahala, 476 U.S. at 967.

In Nantahala, the North Carolina Utility Commission concluded that FERC's allocations of low-cost, wholesale power were improper. In effect, the State Commission replaced FERC's order with one that the Commission thought to be

more fair. It thereby made a conflicting decision about the allocation of power within an interstate power pool.

In delivering the opinion for this Court, Justice O'Connor reasoned that a decrease in retail rates would be improper if based only upon an allocation calculation that ignored the FERC allocations. Id. at 968. Justice O'Connor was also careful to point out, however, that a decrease in retail rates would be proper and within the State Commission's power and jurisdiction provided that decrease was based on other factors, such as lower transmission or operational costs. Id.

As the Fifth Circuit correctly recognized, Nantahala clearly leaves room for the local ratemaking authority to disallow imprudent operating expenses

as long as those expenses do not contradict FERC's allocations. That is, the Nantahala decision fully recognizes the area of decisionmaking still reserved to state regulators under the Act; the Council's proceedings fall well within that reserved area. See NOPSI III, 491 U.S. at 352, 367. Those proceedings found NOPSI's management to have been grossly deficient in failing to investigate possible reductions of economic risks.

In MP&L, this Court ruled that an inquiry by the Mississippi Public Service Commission into the prudence of management decisions concerning the construction and completion of the Grand Gulf nuclear facility was preempted. In that case, FERC had found the decision to build to be reasonable, and had allocated power from the facility among

MSU subsidiaries. Hence, a State inquiry into the wisdom of constructing the plant was invalid -- an example of preemption by conflict. MP&L, 487 U.S. at 376.[15]

In the instant case, by contrast, the Council's Order does not question the reasonableness of expenses incurred as a result of NOPSI's participation in the Grand Gulf project. Instead, the Council's Order reviews whether NOPSI executives acted imprudently in failing to examine the economic risks of Grand Gulf and nuclear power, and in failing

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15 In MP&L, this Court ruled that the state prudence hearing could not even be held because it was preempted. NOPSI's argument that the same rule applies here is wrong, because it is the "law of the case" that the New Orleans City Council hearing was allowable. See NOPSI III, 491 U.S. at 372 (claim ripe when Council's Order entered); NOPSI v. Council, 833 F.2d 583 (5th Cir. 1987) (claim not ripe before Council investigation held).

to diversify the NOPSI power supply portfolio once those risks become obvious.

Indeed, NOPSI and MSU represented that they entered the nuclear field specifically to diversify. See "Historical Background" section of Counterstatement of the Case, above. Diversification must be considered a continuing goal, not just a one-time-only decision. It requires continued prudent monitoring of risks and of possible instability. In this case, the Council concluded that such monitoring would have led reasonably prudent management to mitigate growing risks through further diversification, or at least through off-system sales.

The Council found that in light of escalating costs of nuclear power, NOPSI should have realized that allocations of

nuclear power by the pool (and later by FERC) would result in serious economic risk and consequently, NOPSI was under the obligation to minimize those risks by diversifying its power sources. See MP&L, 487 U.S. at 367. Further, the Council found that if NOPSI had pursued this course, it could have saved an amount equal to one-third to two-thirds of the amount of its Grand Gulf obligation.

The Council's Order does not question NOPSI's obligation to purchase the FERC allocated power, the quantity, or the price. See NOPSI III, 491 U.S. at 367. While NOPSI could not refuse to purchase the power, it did have the right, and claimed the ability, to sell power off-the-system. Indeed, its officers represented to the Council they could (and would, if necessary) do so,

but NOPSI, as a result of negligent management, failed to pursue this option.

NOPSI boldly asserts that it should not be bound by the promises and representations its own President, James Cain, made to the Council. Its argument, though vitriolic,[16] is misguided. If Cain really believed that off-system sales at an attractive price were possible, his failure to pursue this option was imprudent, so the ratepayers should not suffer. Alternatively, if he did not believe his representations to the City Council when he made them, then he was prevaricating, and, again, the ratepayers should not be responsible. Management decisions --

16 See NOPSI Brief at 44 n.50 and even more strongly in their Application for a Writ of Certiorari filed in the Louisiana Supreme Court, at 17-19.

whether competent, incompetent, or dishonest -- determine costs, see NOPSI Brief at 25 n.27, 44 n.50, but the ratepayers should not have to bear the burden of costs that are inflated because of deficient and seriously imprudent management decisions. J.A. 161. Furthermore, NOPSI's reliance on a footnote in MP&L, see NOPSI Brief at 44 n.50, is also misplaced. In that footnote, this Court simply stated that false statements by the regulated utility cannot alter the federal-state regulatory balance. 487 U.S. at 376 n. 14. That is quite different from the situation here. The Council is simply relying upon Cain's representation -- that NOPSI could find possible buyers -- in order to show that off-system sales were a viable option -- a representation which NOPSI now suggests was either

unreasonable or false when made.

The instant case provides this Court with the opportunity to clarify the line between state and federal jurisdiction over the activities of utilities involved in interstate power pools. This Court should draw that line in a manner which reflects the necessary respect for the delicate balance between these two layers of government in our federal system.

III. THE STATE COURT PROCEEDING IS THE PROPER FORUM FOR NOPSI'S CLAIMS, PARTICULARLY THE "PRETEXT" CLAIM.

Though this Court remanded to the courts below for further proceedings, the federal courts did not need to rule on NOPSI's claims. Instead, they should have stayed the case in favor of the state court proceedings and rulings.

Before the federal district court,

on remand, was able to consider the issues, the state trial court, in a case initiated by NOPSI,[17] rejected both the "facial" preemption claim and the "pretext" claim now pressed upon this Court by NOPSI. This Court will, if it deems necessary, have an opportunity to review any ultimate decision by Louisiana Supreme Court.[18] Hence, there

[17] NOPSI's suit was combined with the suits previously filed by the Alliance and by the Council. See "The State Court Proceedings" section in the Counterstatement of the Case, above.

[18] The Louisiana Court of Appeals for the Fourth Circuit ruled that the Council's Order was supported by substantial evidence, was not preempted by federal law, and did not violate the Commerce Clause. The Court also held that all imprudently incurred costs be borne by NOPSI. Alliance, 578 So.2d 949

NOPSI filed with the Louisiana Supreme Court an application for certiorari, seeking review of the entire Fourth Circuit decision. The Council filed a petition seeking review only of the portion of the decision which forbid any imprudent costs to be passed on to ratepayers. The Alliance has not joined either petition. To date, the Louisiana

is no reason to stretch the boundaries of this case to decide the so called "pretext" claim. Furthermore, there is not a sufficient record in the federal proceedings to allow a definitive ruling on that claim.

A. The Federal Full Faith and Credit Statute Required the Federal District Court to Stay This Case.

Under 28 U.S.C. §1738 (1988), the "judicial proceedings" of "any court of any" state "shall have the same full faith and credit in every court within the United States . . . as they have by law or usage in the courts of such state . . . from which they were taken."

In interpreting this "full faith and credit" provision, this Court has explained: "It is now settled that a federal court must give to a state-court

Supreme Court has not ruled on the petitions.

judgment the same preclusive effect as would be given that judgment under the law of the State in which that judgment was rendered." Migra v. Warren City School Dist. Bd. of Educ., 465 U.S. 75, 81 (1983). See also Allen v. McCurry, 449 U.S. 90, 96 (1980); Kremer v. Chemical Constr. Corp., 456 U.S. 461, 466 (1982); E. CHEMERINSKY, FEDERAL JURISDICTION 440-42 (1989) (Migra illustrates the Supreme Court's view that it is more important to give full faith and credit to state court judgments than to allow separate fora for state and federal claims).

Because § 1738 specifically refers to state law, the credit which the federal courts, in the instant action, should give to the state court judgments is determined by the credit those judgments are given in the Louisiana

courts. The applicable Louisiana statute at the time was the lis pendens provision. La. Code Civ. Proc. Ann. art. 531 (West 1960).[19] It provided:

> When two or more suits are pending in a Louisiana court or courts on the same cause of action, between the same parties in the same capacities, and having the same object, the defendant may have all but the first suit dismissed by the excepting thereto as provided by Article 925. When the defendant does not so except, the plaintiff may continue prosecution of any of the suits, but the first final judgment shall be conclusive of all.

La. Code Civ. Proc. Ann. art. 531 (West 1960). Thus, Article 531 requires that: (1) the state court judgment be a final judgment; (2) the parties be the same in both actions; (3) the relevant cause be the same; and (4) the identity of the thing demanded be the same. See Jensen

[19] A new statute, effective January 1, 1991, also provides res judicata effect. See La. Rev. Stat. Ann. § 13:4231 (West 1991).

Constr. Co. v. Dep't of Transp. & Dev., 542 So.2d 168 (La. App. 1st Cir. 1989).

1. Final Judgment

Under La. Code Civ. Proc. Ann. art. 1841 (West 1990), a judgment is a determination of the parties' rights in an action, and it may be either interlocutory or final. "A judgment that determines the merits in whole or in part is a final judgment." Art. 1841 (emphasis added).

For the purposes of lis pendens, all that must be shown is that the state trial court decision was a final judgment. This is a lower standard than that for res judicata, which, in addition, requires identity of the thing

adjudged.[20] Thus, it is not relevant that the state trial court's decision was appealed, because the only dispositive factor for the purposes of lis pendens is whether the state court's decision was a final judgment.

It is well-established in Louisiana law that a "final or definitive judgment is one which decides all of the points in controversy . . . . The appeal merely

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20 Article 3556(31) defines the "thing adjudged" as that which has been decided by a judgment from which there can be no appeal, either because the appeal did not lie, or because the time fixed by law for appealing has elapsed, or because it has been confirmed on the appeal. La. Civ. Code Ann. art 3556(31) (West 1953). See Preis v. Standard Coffee Service Company, 545 So.2d 1010, 1012 (La. 1989); Ward v. Pennington, 523 So.2d 1286, 1290 (La. 1988); Smith v. Howell Industries, 579 So.2d 1236, 1238 (La. App. 3d Cir. 1991). As that requirement was not met here, the Fifth Circuit was correct in rejecting a res judicata claim. But, as noted, lis pendens has a different, lesser requirement.

suspends the execution of the judgment pending review." Buuck v. Fos, 84 So.2d 186, 187-88 (La. 1955) (emphasis added). See also Voisin v. Luke, 142 So.2d 815, 817 (La. App. 1st Cir. 1962).

In fact, the state trial court here rendered a "final judgment" on the merits of the case. The court held that the Council's actions were not inconsistent with federal law, its conclusions were derived rationally, and they were supported by substantial evidence.

2. Identity of the Parties

Here, there is sufficient identity of the parties to meet the requirement of Article 531. This requirement is met whenever "the same parties, their successors, or others appear so long as they share the same 'quality' as parties." Welch v. Crown Zellerbach

Corp., 359 So.2d 154, 156 (La. 1978). Ultimately, the determination for the identity of the parties requirement "turns on whether the parties added or omitted would be necessary to reach a judgment on all the issues asserted against the common parties in both suits." Fincher v. Insurance Corporation of America, 521 So.2d 488, 490 (La. App. 4th Cir.), writ denied, 522 So.2d 570 (La. 1988).

In the state action, the relevant parties are NOPSI, the Council of the City of New Orleans, and the Alliance and its related groups ["Alliance, et al."]. In the federal action, the named parties are NOPSI and the Council of the City of New Orleans, and the Alliance,

et al., as intervenors.[21]

3. Identity of Cause

For the purposes of Article 531, the term "cause" requires only that the two actions share an identity of the legal demands made. See Safeco Insurance Company of America v. Palermo, 436 So.2d 536, 537 (La. 1983); Mitchell v. Bertolla, 340 So.2d 287, 291-92 (La. 1976) (holding that "cause of action" in art. 2286 means "cause"); Rivet v. First Financial Bank, FSB, 538 So.2d 216, 220-21 (La. 1989).

In the state court action, NOPSI argued that the Council's Rate Order is

[21] The fact that the Alliance, et al. are named parties in the state case and are intervenors in the federal case does not change the "quality" of the parties. The resolution of the issues will not be affected simply because the Alliance, et al. intervened in the action. Moreover, after being granted intervention pursuant to Fed. R. Civ. P. 24, the Alliance, et al. became named parties.

(1) preempted by the FERC allocation order and (2) if not preempted, the Order is unsupported by the evidence. In that action, both the Council and the Alliance disagreed with NOPSI. Further, the Alliance argued that the Council lacked the authority to moderate its disallowance to prevent NOPSI's bankruptcy. Alliance, 578 So.2d at 953.

In the federal action, NOPSI argued that the Council's Rate Order was (1) facially preempted and (2) the stated reasons for the Council's Order were a pretext for an impermissible attack on FERC's order. NOPSI, 911 F.2d at 995. As this comparison reveals, the parallel state and federal proceedings have the facial and "pretext" preemption claims in common.

4. Identity of the Thing Demanded

"In determining whether the requirement of the identity of the thing demanded is met, courts look to the ultimate object of the suit." Jensen, 542 So.2d at 173.

Here, both the state action and the federal actions sought the same type of relief. More specifically, in both the state and the federal actions, NOPSI wants a declaration that the Council's Order was preempted by the FERC decrees. Such a declaration would enable NOPSI to pass on the entire FERC-approved costs to New Orleans ratepayers. Compare NOPSI, 911 F.2d at 997, with Alliance, 578 So.2d at 953.

In both actions, the Council southt to have their investigation and Order uphels. In both cases the Alliance, et al., supported the Council's authority

to conduct the investigation and issue an Order, but sought broader relief for ratepayers.

Therefore, both actions seek review of the Council's authority, with all parties demanding for themselves the same relief in both cases. There is sufficient identity of the thing demanded for purposes of lis pendens. Rivet, 538 So.2d at 221; Jensen, 542 So.2d at 172; Daul Ins. Agency Inc. v. Parish of Jefferson, 447 So.2d 1208, 1211 (La. App. 5th Cir. 1984).

In sum, the facts show that the state and the federal claims have the same parties, the same cause, and the same thing demanded. Thus, the first final judgment, i.e. the state trial court decision, is "conclusive" of all. Moreover, under Migra, 465 U.S. at 80-81, the federal action should never have

proceeded, for if it had been instituted in Louisiana court, that court would have stayed the action on the grounds of lis pendens. Therefore, under § 1738, as interpreted by Migra, the federal district court should have done the same. This Court should dismiss this Petition and remand, with an instruction to stay in favor of the pending state court proceedings.

B. Even if This Court Does Not Apply § 1738, the "Pretext" Claim Should Not be Considered Without a Complete Record.

In any event, proper judicial administration requires waiting for a fully developed record before ruling on the "pretext" claim. The state court proceedings have such a developed record.

If this Court insists upon federal, rather than state, judicial

consideration of the "pretext" claim, then Respondents the Alliance, et al., urge this Court to remand for a full evidentiary hearing (so the issue can be considered on a complete record). The lawyers representing both NOPSI and the Council have agreed that such an evidentiary hearing would be needed. See J.A. 327-29. See also NOPSI III, 491 U.S. at 363-65, 367 (noting the need for factual record on the pretext claim, and describing some of the facts to be considered).

CONCLUSION

For the foregoing reasons, this Court should affirm the Fifth Circuit decision.

In the alternative, this Court should affirm on the facial preemption claim and remand for a full evidentiary

hearing on the so called "pretext" claim.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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PETITIONER'S REPLY BRIEF

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
I. THIS CASE IS CONTROLLED BY *MP&L*, *NANTAHALA*, AND THEIR NUMEROUS PRECURSORS	3
A. FERC Has "Plenary Authority" To Determine Any Claims That NOPSI Was Imprudent In 1980 In Retaining Grand Gulf Power For Future Resale To Its Retail Customers	4
B. FERC Has Jurisdiction Over Claims Of "Imprudent" Omissions To Act	8
C. FERC Has Jurisdiction Over A "Buyer's" Prudence In An Integrated Power Pool	9
D. *Nantahala* And *MP&L* Do Not Prohibit The Recognition Of Wholesale Rate Reductions In Retail Rates	12
E. The *NOPSI III* Decision Has No Pertinence To This Case	13
II. THE COUNCIL HAS RELITIGATED THE VERY MATTERS THAT WERE BEFORE FERC AND HAS COLLATERALLY ATTACKED FERC'S ORDER	13
III. RESPONDENTS' *RES JUDICATA* CLAIMS ARE NOT BEFORE THIS COURT AND ARE, IN ANY EVENT, MERITLESS	17
CONCLUSION	19

TABLE OF AUTHORITIES

Cases — Page

Alliance for Affordable Energy, Inc. v. *Council of New Orleans*, 578 So. 2d 949 (La. App. 4th Cir. 1991), *certiorari granted* (La. Sup. Ct. Sept. 27, 1991) 18
Arkansas Louisiana Gas Co. v. *Hall*, 453 U.S. 571 (1981) 16
Bishop v. *Wood*, 426 U.S. 341 (1976) 19
Chicago & N.W. Transp. Co. v. *Kalo Brick & Tile Co.*, 450 U.S. 311 (1981) 4, 12, 15
FERC v. *Mississippi*, 456 U.S. 742 (1982) 6
FPC v. *Southern California Edison Co.*, 376 U.S. 205 (1964) 5
Garcia v. *San Antonio Metropolitan Transit Authority*, 469 U.S. 528 (1985) 6
Kentucky West Virginia Gas Co. v. *Pennsylvania Public Utility Commission*, 837 F.2d 600 (3d Cir. 1988) 9
Massachusetts v. *United States*, 729 F.2d 886 (1st Cir. 1984) 11
Mississippi Power & Light Co. v. *Mississippi ex rel. Moore*, 487 U.S. 354 (1988) ..... *passim*
Nantahala Power & Light Co. v. *Thornburg*, 476 U.S. 953 (1986) ..... *passim*
NOPSI v. *Council of New Orleans*, 491 U.S. 350 (1989) 13
Pennsylvania Water & Power Co. v. *FPC*, 343 U.S. 414 (1952) 8
Pike County Light & Power Co. v. *Pennsylvania Public Utility Commission*, 77 Pa. Commw. 268, 465 A.2d 735 (1983) 9
The Shreveport Rate Cases (*Houston, E. & W. Tex. Ry.* v. *United States*), 234 U.S. 342 (1914) 6
TWA v. *Thurston*, 469 U.S. 111 (1985) 17
Younger v. *Harris*, 401 U.S. 37 (1971) 13

Administrative Decisions

AEP Generating Co., 35 FERC (CCH) ¶ 61,226 (1986) 9

TABLE OF AUTHORITIES—Continued

Page

AEP Generating Co. and Kentucky Power Co., 38 FERC (CCH) ¶ 61,243 (1987) 9
Middle South Energy, Inc., FERC Opinion No. 234, 31 FERC (CCH) ¶ 61,305 (1985) 15

Statutes

Federal Power Act, 16 U.S.C. §§ 791-828
Section 201, 16 U.S.C. § 824 ..... 4, 5
Section 306, 16 U.S.C. § 825e 11, 14
15 U.S.C. § 79a(a) 5
28 U.S.C. § 1738 17
Louisiana Code of Civil Procedure
Art. 531 18
Art. 532 18

Miscellaneous

Mississippi Power & Light Co. v. *Mississippi ex rel. Moore*, No. 86-1970
Appellant's Reply Brief (filed Feb. 9, 1988) .. 2
Brief Of Appellee State Of Mississippi (filed Jan. 22, 1988) 2, 9
Brief Of Council Of City Of New Orleans As Amicus Curiae (filed Jan. 22, 1988) 2, 9
P. Bator, et al., *Hart And Wechsler's The Federal Courts And The Federal System* (3d ed. 1988) .. 13

IN THE

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OCTOBER TERM, 1991

No. 90-1156

NEW ORLEANS PUBLIC SERVICE INC.,
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THE COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*,
Respondents.

PETITIONER'S REPLY BRIEF [1]

Respondents and their *amici* admit the single fact that controls this case: The Council of the City of New Orleans ("Council") has barred NOPSI from recovering in retail rates—and thereby has "trapped"—over $135 million in the Grand Gulf costs that FERC found "just and reasonable" and ordered NOPSI to incur. As petitioner, FERC, and the Solicitor General previously demonstrated in detail, this single fact means that this case is squarely controlled by this Court's prior decisions in *MP&L*,[2] *Nantahala*,[3] and their numerous precursors.

Nantahala holds that this "trapping" of costs is prohibited. 476 U.S. at 965. It categorically states that a State may not do what the Council concededly has done: "exercise its undoubted jurisdiction over retail sales" to prevent a utility from "recovering the costs of paying the

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[1] The Rule 29.1 Statement appears at p. ii of Petitioner's Brief.

[2] *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, 487 U.S. 354 (1988).

[3] *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986).

FERC-approved rate." *Nantahala*, 476 U.S. at 970. *MP&L* applied this principle to the very Grand Gulf costs at issue here. It holds that retail ratemaking bodies are required by the Supremacy Clause to permit MP&L, NOPSI, and each other MSU operating company "to recover as a reasonable operating expense costs incurred as the result of paying a FERC-determined wholesale rate for a FERC-mandated allocation of power." *MP&L*, 487 U.S. at 373.

Indeed, *MP&L* categorically held that the Supremacy Clause prohibits any form of state prudence review when, as there and here, its "purpose . . . [is] to determine whether the costs FERC had directed [an MSU operating company] to pay for its allocation of Grand Gulf power should be 'trapped' [and borne by shareholders] or passed on to . . . retail customers." *Compare MP&L*, 487 U.S. at 372 & n.12, *with* Pet. Br. 13 (quoting Council's resolution). Thus, in *MP&L*, this Court rejected the arguments of Mississippi and of the Council as *amicus* that the Court should remand the case to allow the Mississippi PSC to "undertake" a prudence review. 487 U.S. at 372. The Court so held in the face of the parties' and the Council's statements that the Mississippi PSC could then have adopted the same "prudence" theories that the Council's Order adopts. *See* Pet. Br. 31-34 & n.39.[4] In short, no amount of revisionism (*see* Council Br. 39) can alter the fact that the Council's Order is preempted under the holding in *MP&L*.

The arguments of respondents and their *amici* confirm these points. Each argument that they advance was previously raised, and rejected, in *MP&L*, *Nantahala*, and

[4] *See* Brief Of Council Of City Of New Orleans As Amicus Curiae, *MP&L*, No. 86-1970, pp. 10-11 & 15-24 (filed Jan. 22, 1988); Brief Of Appellee State Of Mississippi, *MP&L*, No. 86-1970, pp. 25-26 & 34-37 (filed Jan. 22, 1988) (making Council's arguments based on "cost savings in other areas"); Appellant's Reply Brief, *MP&L*, No. 86-1970, pp. 18-19 n.22 (filed Feb. 9, 1988) (discussing Council's $135 million disallowance).

their precursors. Their position would further nullify "Congress' desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the States do not interfere with this authority." *Nantahala*, 476 U.S. at 966; *see MP&L*, 487 U.S. at 373.

This Reply will be confined to three major points. Part I will demonstrate that the various jurisdictional claims of respondents and their *amici* are flatly contrary to *MP&L* and *Nantahala* and that the respondents' attempts to invoke the earlier *abstention* decision in this case are baseless. Part II will demonstrate that, like Mississippi's contentions in *MP&L*, the findings in the Council's Order are in conflict with FERC's actual and implicit determinations. Finally, Part III will show that respondents' *res judicata* arguments are barred by their failure to file a cross petition, and, in any event, are meritless.

I. THIS CASE IS CONTROLLED BY *MP&L*, *NANTAHALA*, AND THEIR NUMEROUS PRECURSORS.

What is most striking about the briefs of respondents and their *amici* is that they do not defend—but abandon—the ground for the Fifth Circuit's judgment: its holding that FERC has jurisdiction only over initial decisions to "participate" in a power pool project, but not over claims that utilities "acted [im]prudently" after construction of a wholesale plant was underway." J.A. 23, 25; Cert. App. 14A, 16A. Contrary to this holding, respondents and their *amici* now concede that FERC has exclusive jurisdiction over the "managerial prudence" of the construction and completion of Grand Gulf and over the reasonableness of the FERC-approved Grand Gulf rates. *E.g.*, Council Br. 36 n.54 & 42-43.

However, they make a series of arguments that would permit these principles to be evaded at will. In particular, although conceding that FERC has jurisdiction to determine whether it was imprudent for NOPSI to *have had* contingent interests in Grand Gulf power for resale to

retail customers, they claim that it is the Council, not FERC, that has jurisdiction to determine whether it was prudent for NOPSI to "*retain*" those interests in 1980. *See* Council Br. 33-34.

But it is elementary that the preemptive effects of federal regulatory schemes cannot be evaded through such "artful pleading." *Chicago & N.W. Transp. Co.* v. *Kalo Brick & Tile Co.*, 450 U.S. 311, 324 (1981). Here, moreover, respondents are urging a distinction without a difference. That is confirmed by the Council's repeated attempts to defend its disallowance order by asserting that the rates that FERC found to be "just and reasonable" are "catastrophically uneconomic." *E.g.*, Council Br. 13, 33. It is further confirmed by the fact that each of the essential findings in the Council's Order represents a factual claim that the Council could have presented to FERC in 1982 and that FERC implicitly or explicitly rejected. *See* pp. 13-17, *infra*.

However, the short answer to respondents and their *amici* is that the jurisdictional distinctions they propose are not only unsupported by the statute, but were *all* raised, and rejected, in *MP&L*, *Nantahala*, and their precursors. As FERC and the Solicitor General have confirmed (Br. 13-25), these economic issues are for FERC, not retail ratemaking bodies.

A. FERC Has "Plenary Authority" To Determine Any Claims That NOPSI Was Imprudent In 1980 In Retaining Grand Gulf Power For Future Resale To Its Retail Customers.

Respondents' principal claim is that recognition of FERC's jurisdiction to determine the "prudence" of NOPSI's Grand Gulf allocation is contrary to the terms and legislative history of the Federal Power Act. Council Br. 29-32; Alliance Br. 29-38. Respondents acknowledge that Section 201 gives FERC plenary authority to assure that the rates for wholesale sales of electricity in interstate commerce, and contracts affecting them, are "just

and reasonable." However, they rely on Section 201(a)'s proviso that FERC's jurisdiction "extend[s] only to those matters which are not subject to regulation by the States" and to various statements in the Act's legislative history to that same effect. In their view, if state regulation of the prudence of any aspect of NOPSI's purchases of Grand Gulf capacity would be constitutional under the Commerce Clause—as they claim the Council's Order is (*see* Council Br. 45)—it means that FERC has no jurisdiction to regulate it.

This very claim was rejected in *MP&L*. *Compare* 487 U.S. at 374 (Opinion for the Court), *with id.* at 387-88 (Brennan, J., dissenting) (citing same legislative history and same proviso in Section 201). *MP&L* reaffirmed this Court's earlier holding in *FPC* v. *Southern California Edison Co.* that FERC jurisdiction does not depend on a "case by case analysis of the impact of state regulation on the national interest." 376 U.S. 205, 215 (1964). *Southern California Edison Co.* held that this proviso in Section 201 is "merely a policy declaration . . . of great generality," that it "cannot nullify [Section 201's] clear and specific grant of jurisdiction [to FERC]," and that the proviso simply codified the "bright line" between state and federal authority that existed when the Federal Power Act was passed. *Id.* at 215-216. Under that line, FERC has plenary authority to determine any and all matters that relate to the reasonableness of interstate rates and the contracts and allocations that affect them. *Id.* at 216; *MP&L*, 487 U.S. at 374-75.

Indeed, rather than seek to preserve exclusive state regulation of some aspects of integrated interstate power pools (*see* Council Br. 31), Congress contemporaneously found in the Public Utility Holding Company Act that sales and exchanges of power within these pools "are not susceptible of effective control by any State." 15 U.S.C. § 79a(a).[5]

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[5] In this regard, there is no substance to the Alliance's suggestion (Br. 44-45) that NOPSI's and the Solicitor General's claims some-

For these reasons, *MP&L*, *Nantahala*, and numerous prior decisions of this Court uniformly hold that FERC's jurisdiction preempts any state law, no matter how it is labeled, that would have the *effect* of interfering with FERC's regulation of wholesale rates and contracts affecting them. *See* Pet. Br. 28-29 & n.37. Here, as in *MP&L*, the decisive fact is that the effect of the Council's Order would nullify FERC's Order for the only purpose that matters in an integrated system—recovery of costs from the ultimate customers. Indeed, contrary to the Council's misstatements (*e.g.*, Br. 20), FERC recognized in its Orders—as New Orleans than argued (*see* Pet. Br. 8 & n.10)—that these FERC-mandated costs would have to be included in retail sales. *See MP&L*, 487 U.S. at 375.

Similarly, each of respondents' other claims proceeds from a misapprehension of the scope of FERC's jurisdiction and from a series of arguments that were raised and rejected in *MP&L* and *Nantahala*.

First, the Council is simply wrong in contending that FERC's jurisdiction is limited to "allocat[ing] the power and cost of Grand Gulf *among* the individual [MSU] operating companies" and to "establish[ing] their *relative* shares" of the plant's costs, even if those costs are "catastrophically uneconomic." Council Br. 19 (emphasis in original); *see id.* 13, 20. FERC's jurisdiction is not limited to allocating costs. It also determined the "just and reasonable" wholesale rate that each MSU company

how raise Tenth Amendment issues and that the Court should consider whether *Garcia* v. *San Antonio Metropolitan Transit Authority*, 469 U.S. 528 (1985), should be "limited or overruled." The issue in this case is not whether Congress may "use state regulatory machinery to advance federal goals." *FERC* v. *Mississippi*, 456 U.S. 742, 759 (1982). Rather, as in *MP&L* and *Nantahala*, the question is whether Congress may limit a State's power to enter retail rate orders that have a direct effect on wholesale transactions in interstate commerce. That Congress has this power has been settled for eighty years. *See The Shreveport Rate Cases* (*Houston, E. & W. Tex. Ry.* v. *United States*), 234 U.S. 342 (1914).

must pay the owner of Grand Gulf (MSE) for electric capacity and energy. FERC thus has jurisdiction to determine whether costs of the plant were prudently incurred in constructing the plant and to exclude not merely "catastrophically uneconomic" costs, but any "uneconomic costs." *See* Pet. Br. 27-28.

Further, contrary to the Council's statements (Br. 7 & n.11, 44-45), it is entirely beside the point that decisions to construct and complete a plant can sometimes present different considerations than do decisions to sell off power from one plant and purchase power from another—which the Council inaptly analogizes to a sublease of "excess" office space. Br. 44-45.[6] As FERC and the Solicitor General have demonstrated, respondents have ignored that FERC has jurisdiction to determine claims that MSE, NOPSI, or the MSU system should have reduced their costs by selling off Grand Gulf power in 1980 and buying substitute power from some other source instead. *See* SG Br. 16-21; *see also* Pet. Br. 26-27 nn.31-35.

Contrary to the Council's contentions (Br. 33), FERC's regulation established that it was "just and reasonable" —in the only relevant "meaning of this phrase" (*id.*)— for NOPSI to obtain and retain 17% of Grand Gulf for resale to retail customers. The reality is that FERC authorized MSE to recover 100% of its Grand Gulf costs from NOPSI and other MSU companies. As *MP&L* recognized (487 U.S. at 362-64), FERC could do so only because it implicitly found not merely that the Grand Gulf construction costs were reasonable, but also that the MSU sys-

[6] The Council's "sublease" metaphor is inapt because it erroneously implies that NOPSI did not need the Grand Gulf power and would be better off if it were "subleased" out at whatever price the market would bear. That is false. NOPSI needs every megawatt of its Grand Gulf allocation, and it would have to acquire substitute power if it sold off Grand Gulf. Thus, the Council's Order assumes a sale of Grand Gulf power at the FERC rates—to a hypothetical "sucker" utility—and a purchase of substitute power at *lower* rates.

tem's *retention* of its 90% interest in Grand Gulf—and its failure to sell off any part of it—were a reasonable means to diversify fuel sources for the benefit of the system "as a whole." In allocating the power, FERC thus necessarily found that the nuclear capacity costs assigned to NOPSI and each other MSU operating company—roughly $800 per megawatt of average demand (*see* Pet. Br. 11 n.14)—were "just and reasonable," did not represent too great a concentration of nuclear capacity, and would not result in "excessive prices" for any class of power consumers. *See Pennsylvania Water & Power Co.* v. *FPC*, 343 U.S. 414, 418 (1952).

B. FERC Has Jurisdiction Over Claims Of "Imprudent" Omissions To Act.

Respondents nonetheless claim that FERC lacks jurisdiction to consider the allegations that it was "imprudent" for NOPSI to retain its then-contingent 17% Grand Gulf share in 1980, rather than "selling off" 8% of it and buying coal power instead. Respondents contend that FERC's authority is limited to reviewing wholesale transactions "*actually filed* with it for approval" and that FERC's jurisdiction cannot be "invoke[d]" where the allegation is that a utility imprudently "*failed* to engage in a transaction." Council Br. 34 (emphasis in original).

This is simply incorrect. FERC's jurisdiction extends to "anything done or *omitted to be done* by any . . . public utility." 16 U.S.C. § 825e (emphasis added); *see* Cert. App. 43A-44A. Indeed, respondents themselves elsewhere acknowledge that FERC routinely exercises jurisdiction to consider claims that a wholesale utility in an integrated system could have and should have reduced costs by selling off power from one source and buying power from a second source. Council Br. 36-37; *see* Pet. Br. 26-27 & nn.33-35; SG Br. 18 & n.9. In those instances, FERC is reviewing claims that, in the Council's words, a "*failure* to seek off-system sales" is imprudent. Council Br. 34 (emphasis in original).

C. FERC Has Jurisdiction Over A "Buyer's" Prudence In An Integrated Power Pool.

Finally, respondents and their *amici* also argue that FERC has no jurisdiction over NOPSI's prudence because NOPSI is a "buyer" of Grand Gulf power. They cite prior FERC statements to the effect that FERC "*generally*" disclaims any jurisdiction to consider the reasonableness of the purchaser's conduct (Council Br. 34), and they rely on the *Pike County* line of cases for the proposition that States can find a buyer imprudent when it voluntarily obtains a particular quantity of power from one source when there was a less costly alternative.[7]

These arguments, too, were made and rejected in *MP&L*.[8] There, all nine members of this Court recognized what FERC has repeatedly held: whereas FERC determines only the *seller's* prudence in an ordinary bilateral transaction, FERC necessarily determines the prudence of "buyer" and "seller" alike when, as here, the power supply arrangements are those of an integrated power pool.[9] In a pooling arrangement, every

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[7] Brief Of The National Association Of State Utility Consumer Advocates As Amicus Curiae In Support Of Respondents, pp. 5-17; *see, e.g., Kentucky W. Va. Gas Co.* v. *Pennsylvania Pub. Util. Comm'n*, 837 F.2d 600 (3d Cir. 1988); *Pike County Light & Power Co.* v. *Pennsylvania Pub. Util. Comm'n*, 77 Pa. Commw. 268, 273-74, 465 A.2d 735, 737-38 (1983); *see also Nantahala*, 476 U.S. at 972.

[8] *See* Brief Of Appellee State Of Mississippi, *MP&L*, No. 86-1970, pp. 14-15, 34-35 (filed Jan. 22, 1988); Brief Of Council Of City Of New Orleans As Amicus Curiae, *MP&L*, No. 86-1970, pp. 19-24 (filed Jan. 22, 1988).

[9] *MP&L*, 487 U.S. at 357, 363, 374-75; *id.* at 378 (Scalia, J., concurring); *id.* at 386 (Brennan, J., dissenting); *see AEP Generating Co.*, 35 FERC ¶ 61,226 (1986) & *AEP Generating Co. and Kentucky Power Co.*, 38 FERC ¶ 61,243 (1987).

member of the pool is simultaneously a "buyer" and a "seller," for the wholesale transaction is a "sale" of power from the pool to those utilities that belong to the pool.[10] Thus, *MP&L* held that FERC's Orders establish that it is "just and reasonable" for MP&L, NOPSI, and each other MSU company to purchase their allocated shares of Grand Gulf at the FERC-approved wholesale rate *for resale* to their retail customers. 487 U.S. at 363 & 375-76.

For the same reason, *MP&L* held that *Pike County* is inapposite to this case: "if the integrity of FERC regulation is to be preserved, it obviously cannot be unreasonable for MP&L to procure the particular quantity of high-priced Grand Gulf power that FERC has ordered it to pay for." *Id.* at 374-75. The Fifth Circuit agreed. Cert. App. 15A; J.A. 24.

These same considerations foreclose the Council's final argument based on NOPSI's putative status as a "buyer." Whereas the Council concedes that FERC has jurisdiction to decide if MSE (as the owner of Grand Gulf) should have engaged in off-system sales in 1980, the Council claims that FERC has no authority to determine if NOPSI should have sold off its then-contingent entitlements in the plant. Council Br. 35-38. That is wrong. The question of whether or when NOPSI could or should sell off contingent interests in an MSU system plant is governed by the MSU System Agreement—which is a binding FERC rate schedule—and epitomizes those matters that FERC has exclusive jurisdiction to decide. *See*

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[10] For example, all members of the MSU pool transfer all the energy they generate to the pool and then effectively repurchase from the pool the power they need for retail operations, and the "price" each MSU company pays for power from the pool is directly related to the "price" it receives for transfers of power to the pool. FERC rate schedules thus govern all the sales and exchanges of power among MSU companies. *See MP&L*, 487 U.S. at 357, 376.

Pet. Br. 4-5 & 26-27. Indeed, under this FERC rate schedule, any sale of Grand Gulf could not occur unless NOPSI and the other MSU companies approve it (through the System Operating Committee), and these schedules and FERC's findings *prohibit* the unilateral sale by NOPSI that the Council has hypothesized. *See* Pet. Br. 4-5 & n.7; p. 15, *infra*.

The Council's contentions vividly confirm that it has redetermined matters within FERC's exclusive jurisdiction. The reality is that if NOPSI had engaged in the hypothesized off-system sales of its contingent entitlements to Grand Gulf in 1980, it would have been making a "sale of electric energy at wholesale in interstate commerce," which is within FERC's exclusive jurisdiction. 16 U.S.C. § 824(b)(1). Further, as FERC and the Solicitor General have demonstrated (Br. 24-25), if any off-system sales had been made in 1980, FERC would have thereafter determined whether and to what extent the benefit of such sales would have been allocated to NOPSI. Contrary to the Council's claims, the Council could not have entered an order in 1980 that compelled NOPSI to enter into the wholesale sales and allocated the benefit of those sales to NOPSI alone.[11] Such orders are plainly preempted by the Federal Power Act.[12] Nor can the

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[11] The premise of the Council's Order is that it would have taken action to "protect" New Orleans's ratepayers "if only" the Council had known in 1980 that NOPSI had then committed to a 29.80% share of Grand Gulf. *See* Council Br. 8; J.A. 136-41. But the action the Council says it would have taken—ordering a sale of all but 9% of NOPSI's then-contingent interest—was beyond the Council's jurisdiction. *See* n.12, *infra*. Further, FERC's subsequent decision regarding AP&L establishes that NOPSI would not have realized the hypothesized savings even if it had engaged in the hypothetical purchases and sales in 1980. *See* Pet. Br. 41-42; S.G. Br. 24-25.

[12] *Massachusetts* v. *United States*, 729 F.2d 886, 887 (1st Cir. 1984) (Breyer, J.) (state commission may not order a utility to enter into a wholesale transaction; rather, a state's exclusive remedy

Council impose a sanction on a utility for having failed to engage in such wholesale transactions. *See Kalo Brick*, 450 U.S. at 324-27.

D. *Nantahala* And *MP&L* Do Not Prohibit The Recognition Of Wholesale Rate Reductions In Retail Rates.

There is similarly no substance to respondents' contentions that FERC's and the Solicitor General's positions would prohibit the Council from adjusting NOPSI's retail rates if NOPSI hereafter sold off some portion of its Grand Gulf allocation. *See* Council Br. 20, 38-39. In that event, rate schedules would be filed with FERC to authorize the off-system sale. Those modified rate schedules would further determine what effect, if any, the sale by NOPSI would have on NOPSI's and the other MSU companies' relative shares of Grand Gulf and on the costs each MSU company would incur under the FERC rate schedule.

Contrary to the Council's claim, petitioner's and the Solicitor General's position would require that *any* resulting savings to NOPSI immediately be reflected in reductions to NOPSI's retail rates. As *Nantahala* and *MP&L* hold, the filed rate doctrine requires only that "a state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price." *Nantahala*, 476 U.S. at 965; *MP&L*, 487 U.S. at 373. If the FERC rate schedules are modified such that a utility's purchased-power expenses are reduced, the utility's retail rates may be, and should be, reduced dollar-for-dollar. *See Nantahala*, 476 U.S. at 967-68. These principles underscore that the question whether wholesale rates and costs are to be effectively reduced is a question for FERC, not for retail ratemaking bodies.

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is to file a complaint with FERC asking *it* to compel the transaction).

E. The *NOPSI III* Decision Has No Pertinence To This Case.

Finally, as demonstrated in detail in Petitioner's Brief (pp. 35-36), there is no substance to the claims that this Court overruled *MP&L* and *Nantahala*, *sub silentio*, in its earlier abstention decision in this case. *See NOPSI* v. *Council of New Orleans*, 491 U.S. 350 (1989) (*"NOPSI III"*). The most this Court held is that the Council's Order is not "flagrantly and patently violative of express constitutional prohibitions in every clause, sentence and paragraph" for abstention purposes. *See id.* at 366-67.

Contrary to respondents' claims, this Court's prior decisions establish that such *abstention* holdings are *not* a decision that the Council's Order is "valid on its face."[13] Indeed, in *NOPSI III*, this Court remanded the case for a determination of that very question. *NOPSI III*, 491 U.S. at 353, 372-73. Further, while only this Court can know what it meant in *NOPSI III*, the language that respondents quote, by its terms, does no more than reflect the fact that *"generally"* prudence investigations of a utility's failure to diversify its power sources are outside FERC's jurisdiction and that state investigations are not "patently" illegal. But, as *MP&L* holds, those investigations are nonetheless facially illegal when FERC orders power purchases within integrated pools. *See* Pet. Br. 36 n.43 & pp. 9-12, *supra*.

II. THE COUNCIL HAS RELITIGATED THE VERY MATTERS THAT WERE BEFORE FERC AND HAS COLLATERALLY ATTACKED FERC'S ORDER.

Respondents have also sought to defend the Council's Order by alleging that the Council did not decide any prudence claims that were actually determined by FERC.

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[13] *See Younger* v. *Harris*, 401 U.S. 37, 53-54 (1971) (rejecting claim of flagrant illegality) & *id.* at 51-52 (holding facial challenge can be litigated thereafter); P. Bator, et al., *Hart And Wechsler's The Federal Courts And The Federal System*, pp. 1402-03 & n.7 (3d ed. 1988).

Council Br. 33-38, 43-48. However, *MP&L* held that the "preemptive effect of FERC jurisdiction" does not depend on "whether a particular matter was actually determined in the FERC proceeding." *MP&L*, 487 U.S. at 374. Even if specific prudence claims were not "decided," "states may not regulate in *areas* where FERC has properly exercised its jurisdiction." 487 U.S. at 374 (emphasis added).

But that is precisely what the Council has done. Contrary to its suggestions (Br. 15-16 & 33-34), the Council has not based its prudence disallowance on any findings that NOPSI had opportunities to achieve cost savings by making off-system sales *after* FERC's Grand Gulf allocation was finalized in 1985.[14] Instead, the Council reviewed the very facts and Grand Gulf decisionmaking that were before FERC, and made determinations that are inconsistent with FERC's in three critical rspects.

First, as the Council does not dispute, the linchpin of the Council's Order was its finding that the MSU system's 1980 Grand Gulf cost estimates were wrong. J.A. 132-34 & 171-208. That estimate, however, was not only before FERC (Pet. Br. 8), but was also the basis for MSU's contention, and FERC's implicit findings, that it was prudent for the MSU system to construct and complete Grand Gulf. *See MP&L*, 487 U.S. at 363. By disallowing over $135 million of NOPSI's FERC-mandated costs on the ground that the MSU system's 1980 cost estimates were "imprudent," the Council has imposed sanctions on conduct that FERC had jurisdiction to declare unreasonable

[14] Although the issue is not presented here, the law is clear that if NOPSI were imprudently to forgo a future opportunity to sell off Grand Gulf power and to replace it with lower-cost coal power, the Council's remedy would be to file a complaint with FERC that challenges this "omi[ssion]" under Section 306 of the Act. Cert. App. 43A-44A. That would enable FERC to decide whether the FERC rate schedules would permit the unilateral wholesale sale, whether it was imprudent not to make it, and, if so, whether the benefits of the hypothetical wholesale transaction should be shared among the other MSU companies, or allocated to NOPSI alone. *See* SG Br. 24-25.

and on grounds that could have been, and should have been, raised before FERC. *See Kalo Brick*, 450 U.S. at 324.

Second, the Council's Brief confirms that it has engaged in the same collateral attacks on the MSU system's integrated capacity planning that this Court held were improper in *MP&L*. *Compare* Pet. Br. 40-41, *with* Council Br. 45-48. The Council acknowledges (Br. 3 n.2 & 48) that the terms of the pertinent FERC rate schedule (the 1973 System Agreement) prohibited NOPSI from unilaterally selling off Grand Gulf power. *See* Pet. Br. 5 & n.7. Further, FERC has rejected the Council's claims that individual MSU companies ever proceeded unilaterally without obtaining the required system approval. *See* 31 FERC at 61,651.

More fundamentally, as this Court held in *MP&L*, FERC's Order rested on its finding that the MSU system's acquisition and retention of its 90% interest in Grand Gulf were "appropriately approach[ed]" on a "system-wide basis," and FERC specifically "rejected" claims based on "local conditions" and the "needs of any one of the operating companies." *MP&L*, 487 U.S. at 376.

In short, the differences between FERC and the Council are not "just a quarrel with the facts." Council Br. 48. By finding that "[s]ystem-wide planning . . . was never deemed inconsistent with the companies taking individual action to achieve a mix of power sources" and that NOPSI should have unilaterally sold off Grand Gulf power in light of local conditions (Council Br. 48), the Council has contradicted FERC's explicit findings and redetermined matters that are in FERC's exclusive jurisdiction.[15]

[15] In this regard, the Council's numerous allegations (*e.g.*, Br. 6 n.9, 12 n.16, 46 & n.68) that NOPSI has insufficient coal-fired capacity relative to other MSU companies are irrelevant to the issue whether NOPSI was "imprudent" in retaining its 17% *Grand Gulf* allocation. FERC allocated Grand Gulf capacity in order to give each MSU company the same nuclear capacity costs per unit of

Third, respondents do not even respond to NOPSI's and the Solicitor General's demonstration that the Council has collaterally attacked FERC's cost allocations. Respondents do not dispute that the FERC Orders *rejected* a claim of the Arkansas parties that is virtually identical to the claim New Orleans would have made if NOPSI had engaged in the 1980 wholesale transactions that the Council hypothesized. *Compare* Pet. Br. 41-43 & SG Br. 24-25, *with* Council Br. 47-48. Nor can respondents dispute that the Council's Order rests on the impermissible "speculation" that FERC would have departed from these cost allocation principles in 1985 if NOPSI had engaged in the hypothetical purchases and sales five years earlier. *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 579 (1981).

Against this background, it is irrelevant for purposes of this case whether the Council's findings are supported by evidence (as the Council claims, *e.g.*, Br. 19, 23-25, 43) or are contrivances (as the District Court and NOPSI have elsewhere suggested). The point is that the Council and FERC have made very different determinations about the reasonableness of the MSU system decisions that led NOPSI (and each other MSU company) to have nuclear capacity costs of roughly $800 for each megawatt of average demand. *See* Pet. Br. 11 n.14.

The question in this case is not who is right or wrong about the reasonableness of these choices. Nor is it

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demand, and FERC found this allocation "just and reasonable" for each MSU company, *regardless* of whether the MSU company satisfied the *remainder* of its customers' demand with oil-fired, gas-fired, or coal-fired capacity. *See* Pet. Br. 9-12 & n.14. Thus, even if the Council could have jurisdiction to find NOPSI imprudent for failing to do what other MSU operating companies did—to acquire coal power *in addition to* their Grand Gulf allocations—the Council has no jurisdiction to disallow NOPSI's Grand Gulf costs. Further, the reason the Council has not sought to disallow any of NOPSI's non-nuclear costs is—as FERC found—that there are no significant disparities in non-nuclear costs among the MSU companies. *See* Pet. Br. 12.

whether the Council's findings are plausible. It is who has jurisdiction to make these determinations: FERC or each of five retail regulatory commissions? As *MP&L* and *Nantahala* hold, the answer is very clear. These are matters within FERC's exclusive jurisdiction and the Council's contrary determinations are thus preempted.

III. RESPONDENTS' *RES JUDICATA* CLAIMS ARE NOT BEFORE THIS COURT AND ARE, IN ANY EVENT, MERITLESS.

Finally, respondents argue that this Court should not decide the preemption question, but should "*reverse*[] [the Fifth Circuit's decision] with the direction that the district court's judgment should be vacated and the action dismissed." Council Br. 48 (emphasis added); *see also* Alliance Br. 97 (seeking "remand, with an instruction to stay in favor of the pending state court proceedings"). The basis for this claim is respondents' allegation that a November, 1989 judgment of a Louisiana state trial court was *res judicata* on all the issues in this case under state law and that 28 U.S.C. § 1738 thus prohibited the District Court from deciding the merits of NOPSI's "facial" preemption claim and required dismissal or stay of the entire case.[16]

Although respondents' Setcion 1738 claim was properly rejected by both lower courts, the short answer is that this claim is foreclosed by respondents' failure to file a cross-petition for certiorari. Although "[a] prevailing party may advance any ground in support of a judgment in his favor," it is well established that "[a]n argument that would modify the judgment . . . cannot be presented unless a cross-petition has been filed." *TWA* v. *Thurston*, 469 U.S. 111, 119 n.14 (1985). Both re-

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[16] 28 U.S.C. § 1738 requires that federal courts give state court proceedings "the same full faith and credit . . . as they have by law or usage in the courts of such State."

spondents are seeking modifications of the Fifth Circuit's judgment.

Further, respondents' claims are wholly inappropriate for review and are baseless. First, the November, 1989 Louisiana trial court judgment has now been superseded by the decision of the Louisiana Court of Appeal. *Alliance for Affordable Energy, Inc.* v. *Council of New Orleans*, 578 So. 2d 949 (La. App. 4th Cir. 1991), *certiorari granted* (La. Sup. Ct. Sept. 27, 1991). And *that* decision ultimately concluded that there was no facial preemption because it gave *res judicata* effect to the Fifth Circuit's facial preemption holding. *Id.* at 965-66. In short, respondents would have this Court direct the Fifth Circuit to give preclusive effect to a state court decision that in turn gives preclusive effect to the Fifth Circuit's decision now before the Court.

Second, respondents' claims rest on *lis pendens* provisions of the Louisiana Code of Civil Procedure that are inapplicable to this case by their own terms.[17] As both the District Court and the Fifth Circuit concluded, the question of the preclusive effect of the November, 1989 state trial court judgment is governed by the provisions of Louisiana law dealing with *res judicata*, and these provide that the state trial court judgment is not *res*

[17] The Louisiana *lis pendens* provisions consist of two paired provisions, Louisiana Code of Civil Procedure art. 531 and art. 532. By their terms, neither of these statutes applies to the current situation. Article 531 addresses the situation when "two or more suits are pending in a *Louisiana court or courts.*" (Emphasis added.) That is not the situation here, where one suit (really three consolidated suits) is pending in the state courts, and another is pending in the federal courts. Article 532 *is* addressed to the situation where "a suit is brought in a Louisiana court while another is pending in a court of . . . the United States." But Article 532 is expressed in terms of a grant of discretionary authority to Louisiana courts. It allows a Louisiana court to "stay all proceedings in the second suit until the first has been discontinued or final judgment has been rendered." Unlike Article 531, it does not direct the Louisiana courts to give preclusive effect to any prior decision.

judicata under Louisiana law because the state appellate process is not yet complete. *See* Pet. Br. 17 n.21; *accord* Alliance Br. 90 n.20. There is no basis for this Court to depart from its practice of accepting the construction of state law that has been adopted by both of the courts below. *See Bishop* v. *Wood*, 426 U.S. 341, 346 (1976).

CONCLUSION

For these reasons, and those set forth in Petitioner's Brief, the judgment of the United States Court of Appeals for the Fifth Circuit should be reversed and the case should be remanded for entry of judgment for NOPSI.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1991

NEW ORLEANS PUBLIC SERVICE, INC., PETITIONER

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE SUPPORTING PETITIONER

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QUESTION PRESENTED

Whether *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, 487 U.S. 354 (1988), and *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), entitle an electric utility that is a member of an integrated multi-state holding company system to recover in retail rates its share, as mandated by the Federal Energy Regulatory Commission, of the costs of an electric generating facility that supplies power to members of the system.

TABLE OF CONTENTS

	Page
Interest of the United States and the Federal Energy Regulatory Commission	1
Statement	2
Summary of argument	11
Argument:	
The Council's order is preempted because it interferes with FERC's exclusive jurisdiction to regulate interstate wholesale sales of electric power among the members of the MSU system	13
A. *Nantahala* and *Mississippi Power & Light* specifically foreclose the Council's disallowance of FERC-mandated costs	14
B. The fact that the Council's disallowance is tied to NOPSI's assertedly imprudent failure to sell off its Grand Gulf participation is immaterial	15
1. FERC had jurisdiction to determine whether it was imprudent for NOPSI to retain its interest in Grand Gulf	16
2. The Council's order undercuts FERC's ratemaking authority	21
C. *NOPSI III* did not approve the Council's prudence inquiry	25
Conclusion	27

TABLE OF AUTHORITIES

Cases:

Arizona Public Serv. Co.:	
25 F.E.R.C. ¶ 63,025 (1983)	19
27 F.E.R.C. ¶ 61,185 (1984)	19
Arkansas Louisiana Gas Co. v. *Hall*, 453 U.S. 571 (1981)	25
Burford v. *Sun Oil Co.*, 319 U.S. 315 (1943)	9
City of Tacoma v. *Taxpayers of Tacoma*, 357 U.S. 320 (1958)	20

Cases—Continued: Page

Connecticut Power & Light Co., 43 F.E.R.C. ¶ 63,029 (1988), aff'd, 48 F.E.R.C. ¶ 61,139 (1989) 18, 19
FPC v. *Southern California Edison Co.*, 376 U.S. 205 (1964) 16, 21
Kansas Gas & Electric, 39 F.E.R.C. ¶ 63,013 (1987), aff'd, 49 F.E.R.C. ¶ 61,295 (1989) 19
Kentucky West Virginia Gas Co. v. *Pennsylvania Public Utility Comm'n*, 837 F.2d 600 (3d Cir.), cert. denied, 488 U.S. 941 (1988) 25
Middle South Energy, Inc.:
26 F.E.R.C. ¶ 63,044 (1984) 2, 4, 6, 24
31 F.E.R.C. ¶ 61,305 (1985) 4, 5, 6, 13, 14, 16, 20, 24
32 F.E.R.C. ¶ 61,425 (1985) 4, 5, 6, 17, 22
Middle South Services, Inc., 30 F.E.R.C. ¶ 63,030 (1985) 3, 4, 20
Mississippi ex rel. Pittman v. *Mississippi Public Serv. Comm'n*, 506 So. 2d 978 (Miss. 1987) 7
Mississippi Industries v. *FERC*, 808 F.2d 1525, modified, 822 F.2d 1103 (D.C. Cir.), cert. denied, 484 U.S. 985 (1987) 4-5, 21
Mississippi Power & Light Co. v. *Mississippi ex rel. Moore*, 487 U.S. 354 (1988) ..... *passim*
Montana-Dakota Utilities Co. v. *Northwestern Public Serv. Co.*, 341 U.S. 246 (1951) 14
Nantahala Power & Light Co. v. *Thornburg*, 476 U.S. 953 (1986) 2, 14, 25
New England Power Co., 31 F.E.R.C. ¶ 61,047 (1985), aff'd *sub nom. Violet* v. *FERC*, 800 F.2d 280 (1st Cir. 1986) 19
New Orleans Public Service, Inc. v. *Council of the City of New Orleans*, 491 U.S. 350 (1989) 2, 9, 10, 25, 26
NOPSI v. *City of New Orleans*, 782 F.2d 1236, modified, 798 F.2d 858 (5th Cir. 1986), cert. denied, 481 U.S. 1023 (1987) 9
NOPSI v. *Council of the City of New Orleans*, 833 F.2d 583 (5th Cir. 1987) 9
NOPSI v. *Council of the City of New Orleans*, 850 F.2d 1069 (5th Cir. 1988) 9

Cases—Continued: Page

Northwest Central Pipeline Corp. v. *Kansas*, 489 U.S. 493 (1989) 20, 21
Pike County Light & Power Co. v. *Pennsylvania Public Utility Comm'n*, 77 Pa. Comm. 268, 465 A.2d 735 (1983) 25
Schneidewind v. *ANR Pipeline Co.*, 485 U.S. 293 (1988) 21
System Energy Resources, Inc., 41 F.E.R.C. ¶ 61,238 (1987), on reh'g, 42 F.E.R.C. ¶ 61,091 (1988), aff'd *sub nom. City of New Orleans* v. *FERC*, 875 F.2d 903 (D.C. Cir. 1989), cert. denied, 110 S. Ct. 1805 (1990) 5
United States v. *Public Utilities Comm'n*, 345 U.S. 295 (1953) 16
United States Railroad Retirement Bd. v. *Fritz*, 449 U.S. 166 (1980) 18
Younger v. *Harris*, 401 U.S. 37 (1971) 9

Constitution and statutes:

U.S. Const. Art. VI, Cl. 2 (Supremacy Clause) 2
Federal Power Act, Tit. II, 16 U.S.C. 824 *et seq.*:
§ 201(b), 16 U.S.C. 824(b) 1, 13
§ 205(a), 16 U.S.C. 824d(a) 4
§ 205(c), 16 U.S.C. 824d(c) 13
§ 206(a), 16 U.S.C. 824e(a) 4, 13

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INTEREST OF THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION

Under Title II of the Federal Power Act, 16 U.S.C. 824(b), FERC has exclusive regulatory authority over the rates charged by public utilities for "the sale of electric energy at wholesale in interstate commerce." Specifically, FERC has exclusive jurisdiction to determine whether the rates charged in such sales—or the rules, regulations, practices, and contracts affecting the rates—are just and reasonable, and not unduly discriminatory

or preferential. Exercising that authority, FERC has issued orders allocating the cost of the nuclear generating capacity of a multi-state public utility holding company system among the operating utilities in the system. In this case, the court of appeals held that the Council of the City of New Orleans, which sets the retail rates for one of those utilities (petitioner), may prohibit petitioner from recovering, from its retail customers, a substantial portion of the costs allocated to it by FERC. If allowed to stand, the court of appeals' decision would nullify FERC's orders allocating costs among the four operating companies and undercut the Commission's exclusive jurisdiction under the Federal Power Act.

We participated, on behalf of the United States and FERC as amici curiae, in two prior cases presenting similar challenges to FERC's exclusive authority under the Federal Power Act, *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), and *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, 487 U.S. 354 (1988). We also participated at an earlier stage of this case in which this Court held that abstention was not appropriate. *New Orleans Public Service, Inc.* v. *Council of the City of New Orleans*, 491 U.S. 350 (1989).

STATEMENT

This case is the latest chapter in extended litigation over who should bear the costs of the Grand Gulf 1 nuclear power plant in Port Gibson, Mississippi. In the course of establishing just and reasonable rates for utilities in an integrated power pool, FERC assigned specified shares of those costs to petitioner, New Orleans Public Service, Inc. (NOPSI), and three other affiliated utilities. In *Mississippi Power & Light*, 487 U.S. at 373, this Court held that the Supremacy Clause required Mississippi to permit one of those utilities to recover the costs imposed by FERC's order from the utility's retail customers. In this case, the New Orleans City Council has entered an order excluding a portion of NOPSI's

FERC-mandated share of Grand Gulf costs from its retail rates. The question presented is whether that order intrudes upon FERC's exclusive jurisdiction under the Federal Power Act.

1. *The Middle South System.*—NOPSI is one of four operating subsidiaries belonging to an integrated holding company system that provides power in the States of Louisiana, Arkansas, Missouri, and Mississippi. The other operating subsidiaries are Louisiana Power & Light (LP&L), Mississippi Power & Light Company (MP&L), and Arkansas Power & Light Company (AP&L). All of the voting stock of the operating utilities is owned by Entergy Corp., a successor to Middle South Utilities, Inc. (MSU). Each operating utility runs generating facilities, buys and sells power at wholesale (among themselves and with outside companies), and sells to retail customers in separate service areas. *Mississippi Power & Light*, 487 U.S. at 357. See *Middle South Services, Inc.*, 30 F.E.R.C. ¶ 63,030, at 65,141-65,142 (1985); *Middle South Energy, Inc.*, 26 F.E.R.C. ¶ 63,044, at 65,095 (1984); Pet. App. 3A-4A.

All of the electric power in the system is distributed through a dispatch center in Pine Bluff, Arkansas. Transactions among the operating companies, including the sale and exchange of capacity and energy, have been governed by a series of "System Agreements" filed with FERC. These agreements "have provided the basis for planning and operating the companies' generating units on a single-system basis and for equalizing cost imbalances among the four companies." 487 U.S. at 357. See 30 F.E.R.C. at 65,141-65,142.

Under the System Agreements, a systemwide Operating Committee, made up of representatives of MSU and its subsidiaries, has coordinated system planning with respect to such matters as generating capacity and sales of bulk power. Before the Grand Gulf project, the individual operating utilities bore responsibility for constructing generating facilities. In 1974, however, when

it became apparent that MP&L would be unable to finance Grand Gulf on its own, a new MSU subsidiary, Middle South Energy (MSE), was formed to own and finance Grand Gulf 1 and to sell its power. Grand Gulf 1 proved far more expensive to build than anticipated. Alhtough the cost of two Grand Gulf units was originally estimated at $1.2 billion, the cost of Grand Gulf 1 alone ultimately exceeded $3 billion. *Mississippi Power & Light*, 487 U.S. at 358 n.2, 359 n.5; *Middle South Energy, Inc.*, 31 F.E.R.C. ¶ 61,305, at 61,653 (1985); 30 F.E.R.C. at 65,152, 65,144-65,145; 26 F.E.R.C. at 65,099-65,103.

2. *The FERC Proceedings.*—In 1982, MSU filed two agreements with FERC. The first, a new System Agreement, set forth the terms and conditions for coordinated operations and wholesale transactions (except for transactions relating to Grand Gulf 1 power) among the operating utilities in the MSU system. The second, the Unit Power Sales Agreement (UPSA), established wholesale rates for MSE's sales of Grand Gulf 1 capacity and energy. Under the UPSA as originally filed, the operating companies were obligated to purchase the following percentages of Grand Gulf capacity: LP&L, 38.57%; MP&L, 31.63%; NOPSI, 29.80%; and AP&L, 0%.[1] The Commission assigned the 1982 System Agreement and the UPSA to separate ALJs for hearings on the question whether each agreement was "just and reasonable" as required by Sections 205(a) and 206(a) of the Federal Power Act, 16 U.S.C. 824d(a), 824e(a). 487 U.S. at 360; 31 F.E.R.C. at 61,633.

FERC consolidated review of the resulting decisions and, in June 1985, issued its order.[2] FERC found that

[1] MSE had sold a 10% share of Grand Gulf 1 to the Mississippi Electric Power Association. 31 F.E.R.C. at 61,668 n.3. The percentages in text refer to the MSU operating utilities' shares in MSE's remaining 90% interest.

[2] *Middle South Energy, Inc.*, 31 F.E.R.C. ¶ 61,305, on reh'g, 32 F.E.R.C. ¶ 61,425 (1985), aff'd *sub nom. Mississippi Industries* v. *FERC*, 808 F.2d 1525, modified, 822 F.2d 1103 (D.C. Cir.), cert. denied, 484 U.S. 985 (1987), on remand *sub nom. System Energy Resources, Inc.*, 41 F.E.R.C. ¶ 61,238 (1987), on reh'g, 42 F.E.R.C. ¶ 61,091 (1988), aff'd *sub nom. City of New Orleans* v. *FERC*, 875 F.2d 903 (D.C. Cir. 1989), cert. denied, 110 S. Ct. 1805 (1990).

"the Middle South companies constitute a highly coordinated integrated electric system" and that "this coordination and integration results in planning, construction, and operations which are conducted primarily for the system as a whole." 31 F.E.R.C. at 61,645. In keeping with the system's overall character, FERC also found that Grand Gulf 1 (like other nuclear units in the system) had been planned "to meet MP&L's needs, to meet System needs, and to meet the System goal of diversifying fuel mix." 31 F.E.R.C. at 61,653. Accord 32 F.E.R.C. at 61,958 ("We reaffirm that the Middle South companies appropriately approach power planning on a systemwide basis, whereby the individual companies' needs are the component parts of the System power plan.").

FERC determined that the UPSA would not "achieve proper cost allocation" and that "some form of equalization of nuclear plant costs is necessary to achieve just, reasonable, and non-discriminatory rates among the MSU operating companies." 31 F.E.R.C. at 61,655. An allocation that would "achieve just and reasonable results," FERC concluded, would require all of the operating companies to share in the investment costs of all of the system's nuclear units (four units, including Grand Gulf 1) "roughly in proportion to each company's share of System demand." *Id.* at 61,655-61,656. To achieve that proportionate allocation of the investment costs of the system's nuclear units, the operating companies were assigned the following shares of the investment costs of Grand Gulf 1: AP&L, 36%; LP&L, 14%; MP&L, 33%; and NOPSI, 17%. *Id.* at 61,655.[3] FERC found that this

[3] To derive these percentages, the Commission took each operating company's share of total system demand in 1982; applied it to the

Grand Gulf allocation, "coupled with the operation of the 1982 System Agreement, will result in just, reasonable, and non-discriminatory rates for the MSU operating companies." *Id.* at 61,566. See 32 F.E.R.C. at 61,950.

In reaching this conclusion, FERC rejected claims that it lacked jurisdiction to require the operating companies to assume shares of Grand Gulf costs that were different from those prescribed by the UPSA. 31 F.E.R.C. at 61,643-61,645; see 32 F.E.R.C. at 61,943-61,952. FERC also rejected arguments by various parties for different allocations of Grand Gulf costs more favorable to those parties' interests. In particular, FERC declined to accept New Orleans' argument that NOPSI should be assigned approximately 9% of the costs of Grand Gulf. See 26 F.E.R.C. at 65,097; 31 F.E.R.C. at 61,634. FERC's orders were sustained on direct review, and this Court denied certiorari. See note 2, *supra*.

3. *Mississippi Power & Light.*—When Grand Gulf 1 went on line on July 1, 1985, MSE began billing the operating utilities for their FERC-mandated shares of Grand Gulf's capacity and energy. The operating utilities, in turn, applied to state authorities for rate increases enabling them to recover those charges from retail customers. Relying on state law providing that only those costs that had been prudently incurred could be included in retail rates, the Mississippi Supreme Court held that MP&L was not entitled to a rate increase enabling it to pass on its share of Grand Gulf 1 unless it could demonstrate that its participation in the project was prudent. The state court remanded for a determination of whether "MP&L, [MSE] and MSU acted reasonably when they constructed Grand Gulf 1," making clear that this inquiry was to encompass whether MP&L's actions had been prudent "*in light of local conditions.*" *Mississippi ex rel. Pittman* v. *Mississippi Public Serv. Comm'n*, 506 So. 2d 978, 985-986 (Miss. 1987).

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total investment costs of all nuclear units in the system; and subtracted, from the resulting figure, any investment by the utility in nuclear units other than Grand Gulf 1. The resulting figures—corresponding to each utility's responsibility for the investment costs of Grand Gulf 1—were expressed as percentages of the total cost of Grand Gulf 1. 31 F.E.R.C. at 61,655.

This Court reversed, holding that Mississippi authorities "may not enter an order 'trapping' the costs MP&L is mandated to pay under the FERC order allocating Grand Gulf power or undertake a 'prudence' review for the purpose of deciding whether to enter such an order." 487 U.S. at 372. The Court explained that "the Supremacy Clause compels the MPSC to permit MP&L to recover as a reasonable operating expense costs incurred as the result of paying a FERC-determined wholesale rate for a FERC-mandated allocation of power." *Id.* at 373.

4. *The Council's Prudence Investigation.*—In the meantime, respondent City Council of New Orleans was conducting its own inquiry into "all aspects of NOPSI's prudence regarding its decision to enter into its arrangements to purchase a portion of Grand Gulf I"; the stated purpose of this inquiry was to "determin[e] what portion, if any, of NOPSI's Grand Gulf I expense shall be assumed by its shareholders, rather than passed through to its retail ratepayers." J.A. 153 (quoting Res. R-85-636). In February 1988, the Council issued a rate order in which it found, *inter alia*, that NOPSI's "oversight and review of its Grand Gulf obligation as the project went forward was uncritical and severely deficient;" that NOPSI "made no effort to reduce its risk exposure" in the wake of the Three Mile Island nuclear incident; and that NOPSI imprudently failed to reduce the risk of its Grand Gulf commitment by "selling all or part of its share off-system" and "purchas[ing] less expensive coal-fired capacity to meet its future needs." J.A. 70-71.

In particular, the Council found that "in 1979-80, NOPSI should have sold substantially all of its Grand Gulf share off the system." J.A. 71. The Council was

"willing to assume," however, "that NOPSI might have retained a portion of Grand Gulf I relative to its comparative size within the MSU system—that is, about 9 percent of the system's Grand Gulf I obligation." J.A. 72. The Council found that the appropriate remedy for this type of imprudence—incorporating the remaining 8% of NOPSI's Grand Gulf share in the retail rate base "only at the cost level of coal-fired power"—"would cause NOPSI to become insolvent and force its bankruptcy." J.A. 72. Consequently, the Council reduced the disallowance to $135 million, an amount it determined to be 10% less than NOPSI could withstand. J.A. 72-73. The order prohibits NOPSI from recovering this sum from its retail customers. *Ibid.*

NOPSI and other parties have sought judicial review of the order in state court. The Louisiana trial and intermediate appellate courts have sustained the findings on which the disallowance was based and have rejected NOPSI's contention that the Federal Power Act preempts the Council's prudence inquiry. See Pet. Supp. App. 1A-48A. The appellate court has ruled, however, that the Council is without authority to reduce the disallowance to preserve NOPSI's solvency; consequently, its ruling would increase the disallowance to more than $400 million. *Id.* at 38A-47A. Requests for further discretionary review are pending before the Louisiana Supreme Court.

5. *The Instant Case.*—After the Council issued its order, NOPSI filed the instant action in federal district court. The complaint sought a declaratory judgment that the order was preempted by federal law as well as preliminary and permanent injunctive relief.[4]

[4] This was the third action in which NOPSI sought relief in federal court from the Council's ratemaking proceeding. The first action, filed in August 1985, sought a determination that NOPSI was entitled to pass its FERC-allocated share of Grand Gulf costs through to retail customers. The court of appeals ultimately held that the federal courts should abstain from exercising jurisdiction over this action. See *NOPSI* v. *City of New Orleans*, 782 F.2d 1236, modified, 798 F.2d 858 (5th Cir. 1986), cert. denied, 481 U.S. 1023 (1987). NOPSI's second action sought to enjoin the Council from taking any action in its prudence inquiry to require NOPSI or its shareholders to absorb any portion of the costs of Grand Gulf. That suit was dismissed, principally on the ground that it was not ripe. *NOPSI* v. *Council of the City of New Orleans*, 833 F.2d 583 (5th Cir. 1987).

a. The district court dismissed NOPSI's complaint, holding that abstention was appropriate under *Burford* v. *Sun Oil Co.*, 319 U.S. 315 (1943), and *Younger* v. *Harris*, 401 U.S. 37 (1971). The court of appeals affirmed. *NOPSI* v. *Council of the City of New Orleans*, 850 F.2d 1069 (5th Cir. 1988). In June 1989, this Court reversed and remanded for further proceedings, holding that abstention was improper on either ground. *New Orleans Public Service, Inc.* v. *Council of the City of New Orleans*, 491 U.S. 350 (1989) (*NOPSI III*).

b. On remand in the district court, NOPSI moved for summary judgment on two alternative grounds: first, that the order was facially preempted and, second, that the Council's reasons for denying a pass-through were a pretext for an attack on FERC's allocation of the costs of Grand Gulf 1. Pet. App. 8A, 26A. The district court ruled that the Council's rate order was not facially preempted, finding that the order "did not question the validity of FERC's allocative decree" or "attempt to regulate interstate utility rates." *Id.* at 27A. The court entered a stay of all remaining proceedings in the case, without addressing the merits of NOPSI's argument that the Council's order was pretextual, in deference to the pending state litigation. *Id.* at 27A-32A.

c. The court of appeals affirmed. Pet. App. 2A-24A. Like the district court, the court of appeals concluded that the Council's rate order was not facially preempted. Under *Mississippi Power & Light* and this Court's other preemption decisions, the court of appeals reasoned, three specific determinations were off limits to the Council.

The Council could not "base any disallowance on NOPSI's purported imprudence in deciding to participate in Grand Gulf in the first place;" it "could not, of course, challenge the FERC price as inappropriate;" and it "could not penalize NOPSI for buying an unreasonably high amount of Grand Gulf power." *Id.* at 14A-15A. Relying on a passage from *NOPSI III*, the court of appeals concluded that the Council order did not embody any of those forbidden determinations. *Id.* at 15A (quoting *NOPSI III*, 491 U.S. at 367).

The court recognized "the well-established principle that if FERC has jurisdiction over a subject, states cannot have jurisdiction over it," and it acknowledged that *Mississippi Power & Light* confirmed that FERC (and not the States) had jurisdiction "to determine whether the various utilities acted prudently in deciding to participate in the Grand Gulf venture." Pet. App. 15A-16A. But the court understood this case to turn on "a variation of that question"—"whether FERC has jurisdiction to determine whether NOPSI acted prudently once the Grand Gulf project was underway." *Id.* at 16A.

The court concluded that FERC does not possess that jurisdiction, advancing several grounds for that conclusion. First, it found that FERC had not "assert[ed] jurisdiction to determine NOPSI's prudence in not acting to minimize its losses." Pet. App. 16A. Second, the court was reluctant to recognize federal jurisdiction that would "work the result" criticized by the dissent in *Mississippi Power & Light*—*i.e.*, that would "divest states of authority to determine the prudence of costs incurred by retail utilities" belonging to interstate power pools. *Id.* at 17A. The court insisted on "a firmer statement of intent before finding such intrusive federal jurisdiction to exist." *Ibid.* Third, the court of appeals was "convinced that [this] Court in *NOPSI III* did not believe the Council could not regulate NOPSI's activities in this regard." *Ibid.* Finally, the court reasoned that "[i]f states may deny pass throughs because costs have gone down in other areas,"

as *Nantahala* stated, "it seems logical that they should be able to deny them because costs would have gone down if the utility had not been imprudent." Pet. App. 18A.

Like the district court, the court of appeals declined to reach the merits of NOPSI's pretext claim. The court found that this claim was, in effect, a challenge to "the sufficiency of the evidence to support the Council's stated reasons for denying the pass through." Pet. App. 21A. Consequently, the court concluded, the district court's decision to stay this case in deference to the litigation pending in state court was not an abuse of discretion. *Id.* at 24A.

SUMMARY OF ARGUMENT

A. This case is a sequel to, and is controlled by, *Mississippi Power & Light*. In order to assure that members of the MSU system bear equitable shares of the costs of the system's nuclear capacity, FERC has reallocated the costs of Grand Gulf 1 among the system's members. Those costs are reflected in the rates at which the operating utilities, including NOPSI, acquire power at wholesale. FERC has determined that its allocation of Grand Gulf costs and the resulting rates are just and reasonable. *Mississippi Power & Light* specifically requires state retail ratemakers, including the Council, to recognize amounts paid pursuant to FERC's orders as reasonable. Those ratemakers may not "trap" any portion of NOPSI's FERC-mandated costs on the ground that it was imprudent for NOPSI to incur them. That is precisely what the Council's order does. Accordingly, that order is preempted.

B. It is immaterial that the Council relied on a theory of imprudence different from that advanced by state authorities in *Mississippi Power & Light*. FERC's exclusive jurisdiction over wholesale transactions among members of an integrated public utility holding company system includes the authority to allocate the costs of acquiring the system's power among the system's members

and to determine whether any portion of those costs should be excluded from wholesale rates. FERC's jurisdiction to consider all prudence issues relevant to those determinations simply leaves no room for inquiry, by retail ratemakers in any of the States in which the system operates, into the prudence of the allocations and rates mandated by FERC.

An order prohibiting a utility from recovering the cost of power that FERC has required it to buy at a price FERC has required it to pay necessarily undercuts FERC's determination that the FERC-mandated terms are just and reasonable. In this case, moreover, the Council's order intrudes on FERC's exclusive jurisdiction in three additional respects. That order distributes the costs of Grand Gulf 1 on the basis of an assumed allocation of costs different from FERC's; it embodies findings regarding the nature of the MSU system that diverge from FERC's; and it rests on an assumption concerning how FERC would have treated a hypothesized off-system sale of Grand Gulf capacity.

C. *NOPSI III* did not approve the Council's order. In that case, this Court held that the lower court should not have abstained from exercising jurisdiction over NOPSI's preemption claims, and it remanded for further proceedings on the merits. The Court's decision cannot fairly be read to address the merits of the question presented here, much less to discard well-established principles applied only the Term before in *Mississippi Power & Light*.

ARGUMENT

THE COUNCIL'S ORDER IS PREEMPTED BECAUSE IT INTERFERES WITH FERC'S EXCLUSIVE JURISDICTION TO REGULATE INTERSTATE WHOLESALE SALES OF ELECTRIC POWER AMONG THE MEMBERS OF THE MSU SYSTEM

The 1982 System Agreement and the UPSA unquestionably provide for "the sale of electric energy at wholesale in interstate commerce," 16 U.S.C. 824(b). Consequently, Section 205(c) of the Federal Power Act, 16 U.S.C. 824d(c), required the members of the MSU system to file the agreements and resulting rates with FERC.[5] FERC has exclusive jurisdiction under the Act to determine whether the rates and agreements are "unjust, unreasonable, unduly discriminatory or preferential" and, if so, to substitute just and reasonable terms. 16 U.S.C. 824e(a).

Exercising that authority, FERC has determined that "the Middle South companies constitute a highly coordinated integrated electric system" in which "planning, construction, and operations * * * are conducted primarily for the system as a whole." 31 F.E.R.C. at 61,645. The Commission's orders permit the system to include 100% of the costs of Grand Gulf 1, and of other system-owned nuclear capacity, in the wholesale rates that members of the system charge one another; they also allocate the costs of Grand Gulf so as to assure that each operating company's contribution to the total costs of the system's nuclear generating capacity is in proportion to the company's share of demand for the system's power. This allocation, FERC has declared, "will result in just, rea-

[5] Under this provision, utilities must file "schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services." 16 U.S.C. 824d(c).

sonable, and non-discriminatory rates for the MSU operating companies." *Id.* at 61,656. NOPSI is obligated by federal law to pay those rates for the power it obtains from the MSU system.[6]

A. *Nantahala* and *Mississippi Power & Light* Specifically Foreclose The Council's Disallowance Of FERC-Mandated Costs

The Council's order would prevent NOPSI from recovering from retail ratepayers the very costs that FERC has determined are just and reasonable. This Court's holdings in *Mississippi Power & Light* and *Nantahala* squarely preclude such an order. As those cases recognize, once FERC has allocated power among members of an integrated public utility holding company system and has established the rates for such power, States are required to honor those determinations in setting retail rates. As this Court declared in *Mississippi Power & Light*, 487 U.S. at 373:

> In this case as in *Nantahala* we hold that "a state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price. . . . Once FERC sets such a rate, a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable. A State must rather give effect to Congress' desire to give FERC plenary authority over interstate wholesale rates and to ensure that the States do not interfere with this authority." *Nantahala*, 476 U.S., at 965, 966. Thus, we conclude that the Supremacy Clause compels the MPSC to permit MP&L to recover as a reasonable operating expense costs incurred as the result of paying a FERC-determined wholesale rate for a FERC-mandated allocation of power.

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[6] *Mississippi Power & Light*, 487 U.S. at 371; *Nantahala*, 476 U.S. at 963-964; *Montana-Dakota Utilities Co.* v. *Northwestern Public Serv. Co.*, 341 U.S. 246, 251-252 (1951).

The fact that the Council has couched its order in terms of NOPSI's asserted imprudence, and has disclaimed any intention of contradicting the FERC-mandated rate and allocation, is wholly immaterial. As in *Mississippi Power & Light*, 487 U.S. at 372, the Council "may not enter an order 'trapping' the costs [NOPSI] is mandated to pay under the FERC order allocating Grand Gulf power or *undertake a 'prudence' review for the purpose of deciding whether to enter such an order*" (emphasis added). The Council's order disallowing $135 million (and the intermediate appellate court's order increasing that sum to more than $400 million) would do precisely that.

B. The Fact That The Council's Disallowance Is Tied To NOPSI's Assertedly Imprudent Failure To Sell Off Its Grand Gulf Participation Is Immaterial

The Council's essential contention, which the court of appeals adopted, is that *Mississippi Power & Light* leaves room for a state prudence inquiry into whether the operating utilities in the MSU should have foreseen FERC's allocation of the system's nuclear costs, sold their respective shares of Grand Gulf capacity, and replaced that capacity with lower-cost coal-fired capacity. In the Council's view, there is a distinction between "(1) the decisions of *intercompany* consequence to *undertake*, to *construct*, and to *complete* the Grand Gulf 1 project, as well as the intercompany *allocation* of costs—all within the FERC's jurisdiction" and "(2) the option available to NOPSI to reduce its risks (and protect its ratepayers) through off-system sales of power—an option that was entirely consistent with both the construction of the plant and the FERC's allocations to NOPSI." Br. in Opp. 3-4. See Pet. App. 14A-15A, 16A. For purposes of federal preemption, the distinction is nonexistent. Just as FERC had exclusive jurisdiction to consider the contention that MP&L acted imprudently, it also had exclusive jurisdiction to consider the Council's prudence theory. A state

ruling on either prudence issue entails the same interference with FERC's exclusive authority.

1. *FERC Had Jurisdiction To Determine Whether It Was Imprudent For NOPSI To Retain Its Interest In Grand Gulf*

As the court of appeals correctly recognized, "if FERC has jurisdiction over a subject, states cannot have jurisdiction over it." Pet. App. 15A-16A. Further, because the Federal Power Act preempts the field assigned to FERC, "the pre-emptive effect of FERC jurisdiction" does not turn on "whether a particular matter was actually determined in the FERC proceedings." *Mississippi Power & Light*, 487 U.S. at 374. The Federal Power Act establishes a "bright line" between state and federal authority. *FPC* v. *Southern California Edison Co.*, 376 U.S. 205, 215-216 (1964). When Congress established federal jurisdiction over public utility "sales for resale in interstate commerce," it "left no power in the states" to regulate those transactions. *United States* v. *Public Utilities Comm'n*, 345 U.S. 295, 311 (1953).

a. In this case, FERC determined that the MSU operating companies are members of an integrated system in which "planning, construction, and operations * * * are conducted primarily for the system as a whole" (31 F.E.R.C. at 61,645). In such a system, FERC's exclusive authority to review the terms of transactions among members encompasses two basic issues. The first is what costs may be reflected in wholesale rates; the answer to that question determines the extent to which those costs will be paid by wholesale purchasers, as opposed to being absorbed by shareholders. Here, FERC's orders establish that 100% of the system's Grand Gulf 1 costs are to be included in the wholesale rates for Grand Gulf power. The second question is how costs included in rates are to

be allocated among purchasers of power.[7] Here, FERC allocated the costs of Grand Gulf 1 and other nuclear capacity in proportion to the operating utilities' shares of system demand.

In *Mississippi Power & Light*, this Court held that FERC's authority over these issues leaves no room for a third inquiry, by retail ratemakers, into whether it was prudent for an individual operating utility to participate in the Grand Gulf project. The Court reasoned that "the prudence of the investment in Grand Gulf * * * was a matter FERC easily could have considered in determining whether to permit MSE to recoup 100% of the costs of Grand Gulf in the wholesale rates it charged to the four operating companies and in allocating Grand Gulf power." 487 U.S. at 375. Moreover, because FERC had "rejected * * * the argument that decisions about the allocation of Grand Gulf costs should be made in light of the needs of any one of the operating companies," the Court continued, FERC's order "specifically bars a state regulatory agency from evaluating the prudence of Grand Gulf 'in light of local conditions' alone." *Id.* at 376. The Court concluded that "[t]he MPSC cannot evaluate either the prudence of MSU's decision to invest in Grand Gulf and bring it on line or the prudence of MP&L's decision to be a party to agreements to construct and operate

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[7] A decision that operating utilities are members of an integrated system does not, of course, require that costs be allocated among system members in precise proportion to their participation in the system. As in this case, members of a system may choose to structure arrangements that preserve some measure of individual autonomy—and some cost differentials—among individual companies. See 32 F.E.R.C. at 61,959. If those agreements are just and reasonable, they will be approved by FERC. Similarly, if FERC determines that such arrangements are unjust, unreasonable, or unduly discriminatory or preferential, it may choose to preserve other differentials that are consistent with its statutory responsibility.

Grand Gulf without traversing matters squarely within FERC's jurisdiction." *Ibid.*[8]

Nothing in this Court's reasoning was limited to the particular form of imprudence at issue in *Mississippi Power & Light*. Nor is any such limitation logically possible. The essential function of the FERC proceeding was to determine whether to include the full costs of Grand Gulf in rates charged among members of the MSU system and the proper allocation of those costs. Accordingly, any assertions that Grand Gulf costs should have been disallowed by FERC because the project was imprudent from the outset, should have been abandoned, was executed in an unnecessarily costly fashion, or should have been sold off-system were within FERC's jurisdiction to determine.[9] The crux of any such claim, regardless of

[8] A concurring opinion by Justice Scalia similarly relied on the fact that "FERC asserts jurisdiction to inquire into the prudence of a part[illegible]tility's entering the arrangement." 487 U.S. at 379 (Scalia, J.[illegible]urring in the judgment). The common ground of the majority and concurring opinions is that the inquiries FERC may undertake foreclose any possibility of a separate state inquiry into prudence. *Id.* at 383 ("After today, the battle will no longer be over who has jurisdiction, FERC or the States, to evaluate the prudence of a particular utility's entering pooling arrangements with affiliated companies for the sharing of electrical generating capacity or the creation and wholesaling of electrical energy."). By contrast, the dissenting opinion argued that the States should be allowed to engage in such an inquiry. *Mississippi Power & Light*, 487 U.S. at 383-384 (Brennan, J., dissenting). At the risk of stating the obvious, the court of appeals was mistaken in relying on the reasoning of the dissent, which a majority of the Court rejected. See Pet. App. 17A. Cf. *United States Railroad Retirement Bd.* v. *Fritz*, 449 U.S. 166, 177 n.10 (1980) ("The comments in the dissenting opinion * * * are just that: comments in a dissenting opinion.").

[9] In fact, FERC has considered claims that it was imprudent for a utility to fail to sell off nuclear power while construction of the plant was underway. For instance, in *Connecticut Power & Light Co.*, 43 F.E.R.C. ¶ 63,029 (1988), aff'd, 48 F.E.R.C. ¶ 61,139 (1989), a state public utility commission argued in a FERC proceeding that a portion of the costs of a nuclear plant should be disallowed because

the form of imprudence asserted, is necessarily (i) that some portion of the cost of Grand Gulf 1 should be excluded from the rate base used to establish the FERC-mandated rates or (ii) that the costs incurred by the system were disadvantageous to a particular utility, relative to other members, in a manner justifying reducing its share.[10]

a utility had not "seriously pursue[d] the desirability of a sell-off in entitlements" to the plant's power. 43 F.E.R.C. at 65,219. An ALJ rejected that contention on the ground that "the sell-down of entitlements in [the nuclear plant] was neither a practical nor desirable solution to the financial problems faced by the utility in the late 1970's," 43 F.E.R.C. at 65,228, and the Commission upheld that determination, 48 F.E.R.C. at 61,546. The Council advanced precisely the same theory in its prudence inquiry. See also *Arizona Public Serv. Co.*, 25 F.E.R.C. ¶ 63,025 (1983), aff'd, 27 F.E.R.C. ¶ 61,185, at 61,350 (1984) (considering the "prudence of [a utility's] action in keeping, rather than selling, a plant").

Connecticut Power & Light and other cases demonstrate that the Commission considers a wide variety of prudence claims. See *New England Power Co.*, 31 F.E.R.C. ¶ 61,047, at 61,081-61,087 (1985), aff'd *sub nom. Violet* v. *FERC*, 800 F.2d 280 (1st Cir. 1986); *Kansas Gas & Electric*, 39 F.E.R.C. ¶ 63,013, at 65,058-65,069 (1987), aff'd, 49 F.E.R.C. ¶ 61,295 (1989). There is no regulatory gap in which the Council may operate. All imprudence claims whose purpose is to determine whether FERC-mandated costs "should be 'trapped' or passed on to * * * retail customers" (*Mississippi Power & Light*, 487 U.S. at 372 n.12) are subsidiary to (and thus encompassed by) FERC's exclusive jurisdiction to establish wholesale rates.

[10] Specifically, there was no obstacle to presentation of the Council's imprudence theory in the FERC proceeding. The Council could have argued, for instance, that it was imprudent for MSE to have failed to sell more than 10% of Grand Gulf off-system. If FERC had agreed with such a contention, it could have disallowed a corresponding portion of Grand Gulf costs from the rates charged to NOPSI and other operating utilities. Alternatively, the Council could have argued that, even if any failure to make off-system sales was prudent from the standpoint of the system as a whole, circumstances that distinguished NOPSI from other utilities with respect to that issue made it appropriate to reduce NOPSI's relative share. What the Council could not do was withhold both arguments and then seek to address a matter encompassed by those issues in its

There is no room left for a state prudence inquiry. It is logically impossible for the following three propositions to coexist: (1) the costs to be recovered in wholesale rates from members of the MSU system for Grand Gulf power (by virtue of the decision to build the facility, the execution of the project, and any asserted failure to sell more than 10% of the project's capacity) are prudent; (2) the costs assigned to each utility are just and reasonable in view of their particular circumstances; and (3) it is imprudent for one or more of the utilities to bear the resulting wholesale rates.

b. The court of appeals thus erred in insisting upon a "firmer statement of [congressional] intent" to preempt the Council's particular prudence theory. Pet. App. 17A. In *Mississippi Power & Light*, this Court did not require any specific demonstration that Congress meant to foreclose Mississippi's precise theory of imprudence when it found that State's inquiry into that subject preempted. Congress's grant to FERC of exclusive jurisdiction over wholesale rates and matters affecting those rates is sufficient to demonstrate an intention to "legislate[] comprehensively to occupy [that] entire field of regulation." *Northwest Central Pipeline Corp.* v. *Kansas*, 489 U.S. 493, 509 (1989).

The court also erred in relying on a finding that FERC "did not assert jurisdiction to determine NOPSI's prudence in not acting to minimize its losses." Pet. App. 16A. To begin with, the Commission *did* recognize that its reallocation of Grand Gulf costs would preclude contrary action by state retail ratemakers.[11] More fundamentally, it is immaterial whether FERC declared its jurisdiction over the precise form of imprudence relied on by the Council. As this Court made clear in *Mississippi Power & Light*, preemption in this context does not turn on whether FERC has actually *addressed* an issue, and the Commission is not obligated to identify and affirmatively declare its jurisdiction over an issue to preserve its exclusive *authority* under the Federal Power Act.[12]

own retail ratemaking proceeding. "The reasonableness of rates and agreements regulated by FERC may not be collaterally attacked in state or federal courts. The only appropriate forum for such challenge is before the Commission or a court reviewing the Commission's order." *Mississippi Power & Light*, 487 U.S. at 375. See *City of Tacoma* v. *Taxpayers of Tacoma*, 357 U.S. 320, 336 (1958).

[11] See 30 F.E.R.C. at 65,148-65,151; 31 F.E.R.C. at 61,644; 32 F.E.R.C. at 61,951-61,952 & n.9. Moreover, one of the principal objections to FERC's orders was that they would unduly displace state retail ratemakers. The D.C. Circuit acknowledged that FERC's orders would be binding on state ratemakers, but nevertheless upheld them. *Mississippi Industries*, 808 F.2d at 1548-1549. Citing *Nantahala*, the court explained that "FERC plainly had authority to approve or reject the cost allocation pursuant to its jurisdiction over wholesale interstate rates despite its inevitable impact on retail rates." *Id.* at 1548.

[12] *Mississippi Power & Light*, 487 U.S. at 375 ("[t]he question of prudence was not discussed * * * because no party raised the issue, not because it was a matter beyond the scope of FERC's jurisdiction"); *id.* at 379 (Scalia, J., concurring in the judgment) ("It is true, of course, that FERC did not conduct [a prudence] examination in the present case; but, * * * neither did any party ask it to do so. That failure to ask does not take the issue out of FERC's jurisdiction and recommit it to the States."). See *Schneidewind* v. *ANR Pipeline Co.*, 485 U.S. 293, 300 (1988); *Northwest Central Pipeline Corp.* v. *Kansas Corp. Comm'n*, 489 U.S. 493, 509 (1989); *FPC* v. *Southern California Edison Co.*, 376 U.S. 205, 215-216 (1964).

2. *The Council's Order Undercuts FERC's Ratemaking Authority*

In a purely formal sense, the Council's prudence order does not relieve NOPSI of the duty to pay for power it draws from the MSU system at the rates prescribed by FERC's orders. But the same could be said of the order contemplated by the proceeding at issue in *Mississippi Power & Light*, and, like that proceeding, the Council's order is preempted nevertheless. The significance of FERC's orders within the scheme of the Federal Power Act is not limited to the legal obligation imposed on

system members to purchase specified amounts of MSU system power at prescribed rates. Those orders also establish that, in purchasing the power allocated to it by FERC at FERC-mandated rates, each utility is assuming a just, reasonable, and non-discriminatory share of system costs that have been prudently incurred. States are not free to reach a different conclusion or to circumvent the Commission's determination. As this Court recognized in *Mississippi Power & Light*, "the Supremacy Clause compels the MPSC to permit MP&L to recover as a reasonable operating expense costs incurred as the result of paying a FERC-determined wholesale rate for a FERC-mandated allocation of power." 487 U.S. at 373.

In this case, the Council determined that "NOPSI should have sold substantially all of its Grand Gulf share off the system" (although it was "willing to assume" that 9% of Grand Gulf's costs could be included in NOPSI's rates). J.A. 71-72. If the Council has the power to determine that NOPSI's retail rates should be calculated as if some or all of its Grand Gulf power came from other sources, all of the other interested retail ratemakers must have the same authority. The upshot would be that while FERC could declare that all of the costs of Grand Gulf capacity could reasonably be included in wholesale rates, the States could respond that none of the utilities could pass on the same costs to retail customers. Since all of the operating companies in the system at issue are wholly owned subsidiaries of MSU, the States would have the power to reduce FERC's ruling to an empty gesture. The fact that the Council has been alone in asserting this form of imprudence and that it has stopped short of a complete disallowance does not alter the fundamental contradiction between its order and FERC's authority.

This fundamental contradiction is present whenever a state retail ratemaker disallows a portion of the costs of purchasing a FERC-mandated allocation of power at a FERC-mandated rate. In the circumstances of this case,

moreover, the Council's order interferes with FERC's exclusive jurisdiction in three additional respects:

First, the Council's order effectively reallocates the costs of Grand Gulf capacity. FERC's orders were based on the premise that 10% of Grand Gulf's capacity was sold off-system (see note 1, *supra*) and that the remaining 90% was allocated in accordance with the percentages in FERC's order. The Council's order rests on the assumption that an additional 8% was sold off-system to a hypothetical buyer and that a correspondingly lower percentage was attributed to NOPSI. The fact that the difference is attributed to NOPSI's allegedly imprudent failure to sell that capacity rather than an imprudent purchase is immaterial. NOPSI has been penalized for paying a higher portion of Grand Gulf costs—costs that are reflected in its FERC-mandated wholesale rates—than the Council has determined to be reasonable.[13] To paraphrase *Mississippi Power & Light*, 487 U.S. at 374, "if the integrity of FERC regulation is to be preserved, it obviously cannot be unreasonable for [NOPSI] to procure the particular quantity of high-priced Grand Gulf power that FERC has ordered it to pay for. Just as Nantahala had no legal right to obtain any more low-cost TVA power than the amount allocated by FERC, it is equally clear that [NOPSI] may not pay for less Grand Gulf power than the amount allocated by FERC."

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[13] For that reason, it is far from clear that the Council's order falls even within the realm that the dissent in *Mississippi Power & Light Co.*, 487 U.S. at 391, would have reserved for state prudence inquiries. In the dissent's view, *Mississippi Power & Light* involved two separate prudence issues: (1) whether "treating [the utility's] participation [in Grand Gulf] as a given" it was imprudent for it to purchase such a high amount of expensive Grand Gulf power; and (2) whether the utility's decision to participate in Grand Gulf in the first place was imprudent. 487 U.S. at 383-384. The dissent recognized that, under *Nantahala*, the first was off-limits to the State. As shown, the Council's determination is indistinguishable in substance from that first inquiry.

Second, the theory underlying the Council's disallowance is at odds with FERC's findings regarding the system and the Grand Gulf project. FERC specifically found that Grand Gulf 1 was undertaken "to meet MP&L's needs, to meet System needs, and to meet the System goal of diversifying fuel mix." 31 F.E.R.C. at 61,653. FERC incorporated in its order the finding of one of its ALJs that "continuing construction of Grand Gulf Unit No. 1 was prudent because Middle South's executives believed Grand Gulf would enable the Middle South system to diversify its base load fuel mix and, it was projected, at the same time, produce power for a total cost (capacity and energy) which would be less than existing alternatives on the system." 26 F.E.R.C. at 65,112-65,113. The theory underlying the Council's order, by contrast, is that NOPSI should have acted alone to substitute coal-fired power for nuclear power. FERC's determination that the full costs of Grand Gulf could be reflected in the system's wholesale rates, based on its findings regarding the plant's role in a systemwide plan to diversify generating capacity, is inconsistent with the Council's determination that NOPSI should have pursued an independent course.

Third, the Council's order embodies an assumption about how FERC would have treated the sales that NOPSI was faulted for failing to have made. According to the Council, NOPSI should have sold its share of Grand Gulf 1 in 1979 or 1980. FERC did not undertake to allocate the costs of Grand Gulf 1 until later. Even if we assume that NOPSI could have succeeded in entering into transactions obligating buyers to assume 8% of Grand Gulf's capacity (the difference between the 17% FERC was later to impose and the 9% the Council was willing to include in retail rates) at the rates later to be imposed on NOPSI, the savings projected by the Council would still have been contingent on FERC's allowing the entire benefit of those transactions to remain with NOPSI. This Court has made clear, however, that no tribunal may

"speculat[e] about what the Commission might have done had it been faced with the facts of this case." *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 579 (1981).[14]

C. *NOPSI III* Did Not Approve The Council's Prudence Inquiry

The court of appeals found support for its conclusion in a passage in this Court's opinion in *NOPSI III*, 491 U.S. at 367. In that case, NOPSI argued that an exception to the *Younger* doctrine for challenges to "state statute[s] 'flagrantly and patently violative of express constitutional prohibitions'" should be extended to this case. See 491 U.S. at 366-367. The Court found it unnecessary to resolve that contention, "since the proceeding and order at issue do not meet that description." *Id.* at 367. The Court continued (*ibid.*):

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[14] The Council's order finds no support, contrary to the court of appeals' view (Pet. App. 17A-18A), in the principle that FERC-mandated costs may be offset by cost savings in areas not subject to FERC's jurisdiction. See *Nantahala*, 476 U.S. at 967-968 (recognizing that wholesale and retail rates could diverge "only if costs *other than* those resulting from the purchase of FERC-regulated power * * * were to decrease"). The Council's order does not offset amounts paid for wholesale power under FERC-mandated rates with other savings outside FERC's jurisdiction. The Council has disallowed the FERC-mandated costs themselves, on the basis of as assumption about how FERC would have handled a hypothetical sale.

Likewise, the court of appeals correctly rejected the Council's reliance on the *Pike County* line of cases. Pet. App. 15A. See, *e.g.*, *Kentucky West Virginia Gas Co.* v. *Pennsylvania Public Utility Comm'n*, 837 F.2d 600 (3d Cir.), cert. denied, 488 U.S. 941 (1988); *Pike County Light & Power Co.* v. *Pennsylvania Public Utility Comm'n*, 77 Pa. Comm. 268, 273-274, 465 A.2d 735, 737-738 (1983). Those cases hold that when a utility has a legal right to refuse to buy power subject to FERC's jurisdiction, retail ratemakers may consider whether the purchase was prudent. They do not apply when, as in this case, FERC has determined the amount of power that each operating utility in an interstate pool is obligated to purchase. See *Mississippi Power & Light*, 487 U.S. at 373-374.

> The Council has not sought directly to regulate interstate wholesale rates; nor has it questioned the validity of FERC-prescribed allocation of power within the Grand Gulf system, or the FERC-prescribed wholesale rates; nor has it reexamined the prudence of NOPSI's agreement to participate in Grand Gulf 1 in the first place. Rather, the Council maintains that it has examined the prudence of NOPSI's failure, after the risk of nuclear power became apparent, to diversify its supply portfolio, and that finding that failure negligent, it has taken the normal ratemaking step of making NOPSI's shareholders rather than the ratepayers bear the consequences. Nothing in this is directly or even indirectly foreclosed by the federal statute, the regulations implementing it, or the case law applying it.

Contrary to the court of appeals' suggestion (Pet. App. 17A), this passage cannot fairly be taken as an indication that this Court "did not believe the Council could not regulate NOPSI's activities in this regard." The only issue before the Court in *NOPSI III* was the "threshold question" whether the district court "properly abstained from exercising jurisdiction in deference to the state review process." 491 U.S. at 353. Whether the order itself was valid was "not at issue." *Ibid.* Indeed, as the court below correctly recognized in another portion of its opinion, *NOPSI III* "held only that the [Council's] order was not 'flagrantly' unlawful for *Younger* abstention purposes; it did not hold the facial preemption claim was foreclosed." Pet. App. 10A.

Just one Term earlier, in *Mississippi Power & Light*, this Court reaffirmed the principle that FERC-mandated allocations of power and wholesale rates are binding in state retail ratemaking proceedings. *NOPSI III* cannot fairly be read to repudiate that principle—which controls this case.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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JULY 1991

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* The Solicitor General is disqualified in this case.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF OF THE AMERICAN GAS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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TABLE OF CONTENTS

	Page
INTEREST OF THE *AMICUS CURIAE*	1
SUMMARY OF ARGUMENT	3
ARGUMENT	
I. THE FIFTH CIRCUIT'S DECISION MUST BE REVERSED BECAUSE IT IS INCONSISTENT WITH THE COURT'S DECISIONS IN *MISSISSIPPI POWER & LIGHT* AND *NANTAHALA*	5
II. THE CITY COUNCIL LACKS JURISDICTION TO CONDUCT AN INDEPENDENT PRUDENCE REVIEW OF NOPSI'S ACTIONS CONCERNING THE ALLOCATION OF GRAND GULF COSTS	8
III. THE COURT OF APPEALS ERRED BY ATTEMPTING TO DISTINGUISH THE CITY COUNCIL'S PRUDENCE REVIEW FROM THAT FORECLOSED IN *MISSISSIPPI POWER & LIGHT*	10
CONCLUSION	13

TABLE OF AUTHORITIES

CASES: Page

Alliance for Affordable Energy, Inc. et al. v. Council of the City of New Orleans, Nos. 90-CA-0420 (Ct. of App. for Louisiana, Fourth Circuit, April 4, 1991) 12

Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571 (1981) 5, 8

Burford v. Sun Oil Co., 319 U.S. 315 (1943) 11

Maryland v. Louisiana, 451 U.S. 725 (1981) 5

Mississippi Power & Light Co. v. Mississippi ex rel. Moore, 487 U.S. 354 (1988) ..... *passim*

Montana-Dakota Utils. Co. v. Northwestern Pub. Serv. Co., 341 U.S. 246 (1951) 5

Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953 (1986) ..... *passim*

Narragansett Electric Co. v. Burke, 119 R.I. 559, 381 A.2d 1358 (1977), cert. denied, 435 U.S. 972 (1978) 11, 12

New Orleans Public Service, Inc. v. Council of the City of New Orleans, 911 F.2d 993 (5th Cir. 1990) ..... *passim*

New Orleans Public Service, Inc. v. Council of City of New Orleans, 491 U.S. 350 (1989) 4, 10, 11

New Orleans Public Service, Inc. v. Council of City of New Orleans, 850 F.2d 1069 (5th Cir. 1988) .. 10

Younger v. Harris, 401 U.S. 37 (1971) 11

ADMINISTRATIVE DECISIONS:

Middle South Energy, Inc.:

26 FERC ¶ 63,044 (1984); 31 FERC ¶ 61,305; on reh'g, 32 FERC ¶ 61,425 (1985), aff'd *sub nom. Mississippi Industries v. FERC*, 808 F.2d 1525, reh'g granted and vacated in part, 822 F.2d 1103 (D.C. Cir.), cert. denied, 484 U.S. 985 (1987), on remand *sub nom. System Energy Resources, Inc.*, 41 FERC ¶ 61,238, aff'd, 42 FERC ¶ 61,091 (1988), aff'd *sub nom. City of New Orleans v. FERC*, 875 F.2d 903 (D.C. Cir. 1989), cert. denied, 110 S. Ct. 1805 (1990) 7, 9, 10

TABLE OF AUTHORITIES—Continued

STATUTES: Page

Federal Power Act, 16 U.S.C. § 824 (1982) 7

Natural Gas Act of 1938, 15 U.S.C. §§ 717-717 *et seq.* (1982) 2, 7, 8

Natural Gas Policy Act of 1978, 15 U.S.C. § 3301 *et seq.* (1982) 2, 8

OTHER AUTHORITIES:

Energy Law and Transactions, § 2.07 (1990) 12

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

No. 90-1156

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF OF THE AMERICAN GAS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

The American Gas Association (hereinafter "A.G.A.") submits this brief *amicus curiae* in support of the petitioner, New Orleans Public Service Inc. (NOPSI).

INTEREST OF THE *AMICUS CURIAE*

The A.G.A. is a national trade association representing the interests of some 250 member companies involved in the distribution and transmission of natural gas throughout the 50 states and the District of Columbia. A.G.A. member companies account for approximately 85 percent of the nation's annual gas utility sales. The

vast majority of A.G.A.'s member companies distribute natural gas to residential, commercial and industrial customers and are extensively regulated by state public utility commissions.

The question presented in this case regarding the scope of the filed rate doctrine is of particular interest to the members of the A.G.A. that are local distribution companies ("LDCs" or "distributors"). LDCs purchase natural gas from pipelines and other sources at rates regulated by the Federal Energy Regulatory Commission (FERC) under the Natural Gas Act of 1938, 15 U.S.C. §§ 717-717w (1982) ("NGA"), and the Natural Gas Policy Act of 1978, 15 U.S.C. § 3301 *et seq.* (1982) ("NGPA"), and distribute and resell that gas to retail customers at rates regulated by state utility commissions. The possibility of dual federal-state oversight could subject an LDC to inconsistent regulation, with FERC approving an LDC payment pursuant to published rates at the wholesale level and a state commission barring the LDC from recovering that same payment through its retail rates. The filed rate doctrine is designed to prevent the "trapping" of such payments by requiring state commissions to allow LDCs to recover through their retail rates all FERC-approved wholesale rates. The doctrine thus plays a crucial role in defining the proper relationship between federal and state regulation of the natural gas industry.

In *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) and in *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988), this Court has refined and affirmed the filed rate doctrine. The decision of the United States Court of Appeals for the Fifth Circuit in *New Orleans Public Service, Inc. v. Council of the City of New Orleans*, 911 F.2d 993 (1990) is clearly inconsistent with the principles articulated by the Court in those decisions. Moreover, the Fifth Circuit's decision may engender confusion about the scope

of the doctrine by leading state utility commissions to conclude that they may prevent a local distribution company from recovering FERC-approved wholesale rates.

A.G.A. recognizes that there should be an opportunity to examine the prudence of a utility's decisions in many areas. However, the Fifth Circuit's decision opens the door to state regulatory agencies relitigating issues which were thoroughly reviewed and lost in the proper federal forum or not even raised at all. Thus, A.G.A. requests this Court to restate its position on the "bright line" drawn by Congress between state and federal authority in the setting of wholesale rates. A clear delineation of the extent of state authority regarding FERC determined wholesale rates is necessary and A.G.A. submits this *amicus curiae* brief urging the Court to reverse the decision of the Fifth Circuit.

SUMMARY OF ARGUMENT

This Court has spoken clearly on the issue of the preemptive impact of federal jurisdiction over wholesale rates charged by interstate pipelines. In *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988) (*Mississippi Power & Light*) and *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) (*Nantahala*), this Court held that pursuant to the filed rate doctrine, state utility commissions in setting retail rates must allow as reasonable operating expenses, payments pursuant to FERC-approved wholesale rates. In the instant case, the Fifth Circuit held that the New Orleans City Council was not preempted from disallowing NOPSI's recovery of $135 million of FERC-approved costs associated with the Grand Gulf I nuclear facility on the grounds such costs were imprudently incurred. This decision must be reversed because it is inconsistent with *Mississippi Power & Light* and *Nantahala*.

The actions of the City Council constitute a collateral attack on FERC proceedings and if allowed to stand,

would have the effect of nullifying FERC wholesale rate orders. *Mississippi Power & Light* held that state regulatory agencies may not conduct independent prudence reviews in order to prevent the recovery of FERC-approved wholesale rates. Therefore, the City Council is bound by FERC's allocation of 17 percent of Grand Gulf I costs to NOPSI, a decision affirmed by the United States Court of Appeals for the District of Columbia Circuit.

Moreover, the Fifth Circuit erred when it misinterpreted language in *New Orleans Public Service, Inc. v. Council of City of New Orleans* (*NOPSI III*), 491 U.S. 350 (1989) and *Nantahala* to support its conclusion that the City Council's rate order was not preempted by federal law. First, the court mistakenly relied upon language in *NOPSI III* holding that the City Council's order was not unlawful for federal abstention purposes to determine the merits of NOPSI's federal preemption claim. Second, the court incorrectly found that the City Council's disallowance of a portion of FERC-approved costs was analogous to circumstances described in *Nantahala*, where retail rates might decrease if costs other than those resulting from the purchases of FERC regulated power or gas were to decrease.

The decision of the Fifth Circuit will lead to uncertainty about the filed rate doctrine and the parameters of the relationship between federal and state regulation of the natural gas and electric power industries. Such uncertainty could have a serious financial impact on local distributors. Accordingly, A.G.A. urges reversal of the Fifth Circuit's decision.

ARGUMENT

I. THE FIFTH CIRCUIT'S DECISION MUST BE REVERSED BECAUSE IT IS INCONSISTENT WITH THE COURT'S DECISIONS IN *MISSISSIPPI POWER & LIGHT* AND *NANTAHALA*.

In *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988) (*Mississippi Power & Light*) and *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) (*Nantahala*), this Court restated fundamental principles concerning the preemptive impact of federal jurisdiction over wholesale rates on state regulation. These decisions were strong affirmations of the "filed rate doctrine," which holds that state and local regulatory authorities in setting retail rates, are without authority to bar recovery of costs incurred pursuant to FERC allocated costs and rates.[1] This result is constitutionally mandated because under the Commerce and Supremacy Clauses of the United States Constitution (U.S. CONST. art. I § 8, cl. 3 and art. VI, cl. 2), states are without authority, either directly or indirectly, to establish or modify rates for the wholesale sale or transportation of natural gas and electric energy in interstate commerce. *See Maryland v. Louisiana*, 451 U.S. 725 (1981).

In *Nantahala*, the Court reversed a decision of the state supreme court allocating costs to the utility differently from the amount allocated by FERC in a wholesale ratemaking proceeding. Holding that the state commission's

[1] The development of the "filed rate doctrine" resulted from the application of principles of preemption in cases involving attempted state agency interference with wholesale rate regulation. Under the doctrine, a state regulatory agency may not exercise authority over retail sales of natural gas or power to prevent a local distribution company from recovering at retail its costs of paying FERC-approved rates for that gas or power. *See Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 (1981); *Montana-Dakota Utils. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251 (1951). In *Nantahala* the Court confirmed that the application of the filed rate doctrine included both FERC-approved rates and FERC-approved cost allocations. 476 U.S. 953 at 966-67 (1986).

allocation was preempted by federal law, the Court found that costs incurred by a utility would be "trapped" unlawfully if they could not be passed on to ratepayers. 476 U.S. at 970.

In *Mississippi Power & Light*, the Court addressed the efforts of a state to avoid passing through FERC-approved costs of the Grand Gulf I project—the very project which is the subject of the instant case. The Court reversed a state supreme court decision which held that the Mississippi Public Service Commission must first examine the prudence of management decisions that led to the construction and completion of Grand Gulf I before passing through FERC-approved wholesale rates. In reversing, the Court found that the only purpose of the state prudence review was to determine whether FERC's allocation of Grand Gulf power to the utility should be "trapped" or passed through to the state's retail customers. 487 U.S. at 372, n.12. Affirming the principles of the filed rate doctrine as discussed in *Nantahala*, the Court held:

> a state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price. . . . *Once FERC sets such a rate, a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable.* A State must rather give effect to Congress' desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the States do not interfere with this authority.

Mississippi Power & Light, 487 U.S. at 373, quoting *Nantahala*, 476 U.S. at 965, 966 (emphasis added).

The City Council's disallowance of $135 million of FERC-approved costs in this current case constitutes a collateral attack on FERC's determination of just and reasonable wholesale rates. Unless reversed, the Fifth Circuit's holding will permit states to further their own

parochial interests by relitigating issues lost at FERC and federal courts in front of a friendlier forum—their own state courts. All of the issues raised by the City Council concerning the recovery of FERC-approved wholesale rates, FERC's jurisdiction to determine the allocation of Grand Gulf I costs, the prudence of the Grand Gulf project, and the merits of such issues, already have been fully litigated and decided in the federal arena, and indeed by this Court. The City Council was an active participant in the FERC proceeding which allocated 17 percent of Grand Gulf I costs to NOPSI, a decision affirmed by the D.C. Circuit and reduced to final judgment.[2]

After losing its case at FERC, the City Council then subsequently conducted an independent prudence investigation and decreased the amount NOPSI could recover. There is no relevant difference between the actions of the City Council and the decision of the Mississippi Supreme Court reversed by the Court in *Mississippi Power & Light*. Accordingly, application of the well-defined principles above mandates the reversal of the Fifth Circuit's decision.

Both *Mississippi Power & Light* and *Nantahala* involved the interpretation of the Federal Power Act, 16 U.S.C. § 824 (1982), under which wholesale sales and transportation of electric power in interstate commerce are regulated by FERC. This is done pursuant to a statutory framework virtually identical to that governing regulation of wholesale sales and transportation of natural gas in interstate commerce under the Natural

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[2] *Middle South Energy, Inc.*, 26 FERC ¶ 63,044 (1984); 31 FERC ¶ 61,305; on reh'g, 32 FERC 61,425 (1985), aff'd *sub nom. Mississippi Industries v. FERC*, 808 F.2d 1525, reh'g granted and vacated in part, 822 F.2d 1103 (D.C. Cir.), cert. denied, 484 U.S. 985 (1987), on remand *sub nom. System Energy Resources, Inc.*, 41 FERC ¶ 61,238, aff'd, 42 FERC ¶ 61,091 (1988), aff'd *sub nom City of New Orleans v. FERC*, 875 F.2d 903 (D.C. Cir. 1989), cert. denied, 110 S. Ct. 1805 (1990).

Gas Act. *See Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 n. 7 (1981). Thus, the principles of the filed rate doctrine apply equally to the wholesale and transportation of natural gas in interstate commerce. Natural Gas Act, 15 U.S.C. § 717(c) (1982). If state regulatory agencies were not required to accept FERC's determination of wholesale rates as just and reasonable, state agencies could undermine FERC's exclusive authority over such wholesale rates, nullify FERC-approved rates, and seriously impact the comprehensive federal scheme of regulation under the Natural Gas Act and Natural Gas Policy Act.

Affirmance of the filed rate doctrine as stated in *Mississippi Power & Light* and *Nantahala* also furthers principles of fairness, protecting distributors from the financial injury that would result if they were caught in the middle of regulatory disputes between FERC and the state regulatory agencies. Uncertainty about the recovery of the payment of filed rates will jeopardize the financial integrity of distributors. A distributor must be assured that it can act on the basis of FERC's decisions that a particular cost is reasonable, without fear that state regulators might conclude differently and prevent the utility from recovering such amounts from its ratepayers. A utility simply cannot stay financially sound or raise additional capital on reasonable terms if it cannot recover its costs.

II. THE CITY COUNCIL LACKS JURISDICTION TO CONDUCT AN INDEPENDENT PRUDENCE REVIEW OF NOPSI'S ACTIONS CONCERNING THE ALLOCATION OF GRAND GULF COSTS.

The issue of whether the City Council can conduct an independent prudence review of NOPSI's actions with respect to the Grand Gulf project has been foreclosed by the courts. The City Council's attempted distinction between the prudence of constructing Grand Gulf and NOPSI's alleged failure to minimize its losses during the

completion of construction is merely an effort to achieve indirectly what it cannot do directly.

This Court ruled in *Mississippi Power & Light* that FERC has jurisdiction to consider questions of prudence regarding the Grand Gulf project in the process of determining the wholesale rates charged by Middle South Energy to the four operating companies and in allocating Grand Gulf's costs and power. 487 U.S. at 375. As a party to the FERC proceeding, the City Council is bound by FERC's allocation of 17 percent of costs associated with Grand Gulf I to NOPSI. During the FERC proceeding, the City Council specifically argued that NOPSI should be allocated only 8.43 percent of Grand Gulf I costs (26 FERC ¶ 63,044 at 65,097 (1984)) and disputed the allocation methodology (26 FERC at 65,105); the administrative law judge discussed the various allocation methodologies proposed by the intervening regulatory authorities, rejected the City Council's proposal, and concluded that NOPSI should bear 17 percent (26 FERC at 65,109). This was expressly upheld by FERC initially (31 FERC ¶ 61,305 at 61,655), on rehearing (32 FERC ¶ 61,425 at 61,959-961) and eventually affirmed by the D.C. Circuit (See note 2, *supra*). If the City Council wanted to litigate issues of prudence which would affect the amount allocated to NOPSI, it should have done so during the FERC proceeding.

Moreover, according to this Court, "FERC's order specifically bars a state regulatory agency from evaluating the prudence of Grand Gulf 'in light of local conditions' alone." 487 U.S. at 376. FERC expressly rejected arguments that allocation of Grand Gulf costs should be based on whether individual companies "need" Grand Gulf's capacity on the grounds that the project was built primarily to serve the system as a whole and the Middle South companies approach power planning on a system-wide basis (32 FERC ¶ 61,425 at 61,958). FERC also rejected the City Council's arguments concerning the al-

location of Grand Gulf costs by finding that MSU is an integrated system (41 FERC ¶ 61,238 at 61,622). FERC further stated, "MPSC did not have any authority to approve an allocation methodology . . . for Grand Gulf . . . any proposed sale of Grand Gulf power and allocation of Grand Gulf costs was subject to review and approval by FERC under the Federal Power Act." 26 FERC ¶ 63,044 at 65,112. As held in *Mississippi Power & Light*, it follows that the City Council "cannot evaluate either the prudence of MSU's decision to invest in Grand Gulf . . . or the prudence of [a utility's] decision to be a party to agreements to construct and operate Grand Gulf without traversing matters squarely within FERC's jurisdiction." 487 U.S. at 376. Thus, the City Council's argument that it has the authority to examine the prudence of NOPSI's actions as they relate to the allocation of Grand Gulf power must fail.

III. THE COURT OF APPEALS ERRED BY ATTEMPTING TO DISTINGUISH THE CITY COUNCIL'S PRUDENCE REVIEW FROM THAT FORECLOSED IN *MISSISSIPPI POWER & LIGHT*.

The Fifth Circuit's finding that the City Council's prudence review could be distinguished from that rejected by this Court in *Mississippi Power & Light* is insupportable. First, the reasoning employed by the Fifth Circuit in order to determine that the City Council's prudence review was not preempted by federal law is erroneous. The Court of Appeals misinterpreted the Court's language in its recent decision in *New Orleans Public Service, Inc. v. Council of City of New Orleans*, 491 U.S. 350, 109 S. Ct. 2506, 105 L.Ed. 2d 298 (1989) (*NOPSI III*). That decision addressed the dismissals by the federal district court and Fifth Circuit of NOPSI's request for injunctive relief and declaratory judgment that the City Council's order was preempted by federal law.[3] In *NOPSI III*, this

[3] *New Orleans Public Service, Inc. v. Council of City of New Orleans*, 850 F.2d 1069 (5th Cir. 1988).

Court reversed and remanded for further proceedings, holding that abstention by the federal courts under *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943) and *Younger v. Harris*, 401 U.S. 37 (1971) was improper. In doing so, this Court stated that "[N]othing in [the City Council's order] is directly or even indirectly foreclosed by the federal statute, the regulations implementing it, or the case law applying it." 491 U.S. at 367, 109 S. Ct. at 2517, 105 L. Ed. 2d at 316. The Fifth Circuit mistakenly relies upon this language to hold that the Court in *NOPSI III* determined that the City Council was not preempted from regulating NOPSI's activities in this regard. 911 F.2d at 1002. However, the Fifth Circuit's reliance upon this language to determine the merits of the federal preemption issue is negated by its own characterization of *NOPSI III* as being limited to the issue of abstention. 911 F.2d at 998. Moreover, the Court of Appeals' finding would effectively result in the reversal of the filed rate and federal preemption doctrines, which had shortly before been upheld by this Court in *Mississippi Power & Light*.

The Fifth Circuit further erred by concluding that the City Council's disallowance of $135 million of Grand Gulf I costs fell within the parameters of circumstances discussed in *Nantahala*, when it stated: "[I]f states may deny passthroughs because costs have gone down in other areas, it seems logical that they should be able to deny them because costs would have gone down if the utility had not been imprudent." 911 F.2d at 1002. This conclusion is based upon a misreading of applicable precedent. In *Nantahala*, the Court noted that "an increase in FERC-approved wholesale rates need not lead to an increase in retail rates" and that ". . . such a divergence between wholesale and retail rates would occur only if costs *other than* those resulting from the purchases of FERC-regulated power or gas were to decrease." 476 U.S. at 968, citing *Narragansett Electric Co. v. Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972

(1978) (emphasis in the original). This statement merely recognizes that retail rates are calculated on the basis of a large basket of costs. Those costs include FERC-approved payments to interstate pipelines, which are not subject to state manipulation or review, and other costs which may be examined at the state level. Examples of such costs which are not regulated by FERC but are components of an LDC's retail rates include taxes, depreciation of physical plant and all other operating expenses. A utility that must pay higher FERC-approved rates might be able to offset its overall costs of doing business as a result of efficiencies leading to reduced operating costs, or changes in exogenous variables such as the weather or economic conditions affecting the cost of capital.[4] Clearly, the Court's observation in *Nantahala* does not apply to the instant case where the City Council expressly decreased the amount of FERC-approved costs to be recovered.

The decision of the Fifth Circuit will leave courts uncertain about the application of the filed rate doctrine and may lead state regulatory agencies to conclude that they have greater latitude in disallowing recovery of FERC-approved wholesale rates than this Court intends. The recent ruling in the parallel state proceeding between these parties is a result of that uncertainty. On April 4, 1991 the Fourth Circuit Court of Appeals for Louisiana issued its decision in *Alliance for Affordable Energy, Inc. et al. v. Council of the City of New Orleans*, Nos. 90-CA-0420, which addressed the appeals of the Alliance for Affordable Energy and NOPSI of the City Council's rate order. The state appellate court held that NOPSI could only recover approximately 9 percent of Grand Gulf costs, the same amount urged by the City Council and rejected by FERC. The state court's ruling demonstrates that the relationship between state law inquiries and the comprehensive scheme of federal regulation must be clearly defined and necessitates reversal of the Fifth Circuit's decision.

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[4] *Energy Law and Transactions*, § 2.07 (1990).

CONCLUSION

For the foregoing reasons, the judgment of the United States Court of Appeals for the Fifth Circuit which is inconsistent with *Mississippi Power & Light Co. v. Mississippi ex. rel. Moore*, 487 U.S. 354 (1988) and *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) should be reversed.

Respectfully submitted,

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On Appeal from the United States Court of Appeals for the Fifth Circuit

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BRIEF OF EDISON ELECTRIC INSTITUTE AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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TABLE OF CONTENTS

	Page
OPINION BELOW	1
INTEREST OF EDISON ELECTRIC INSTITUTE	1
STATEMENT OF THE CASE	4
SUMMARY OF ARGUMENT	7
ARGUMENT	8
THE OPINION BELOW VIOLATES THE PREEMPTION DOCTRINE OF *NANTAHALA* AND *MP & L*, THREATENING THE PROPER AND WELL-ESTABLISHED RELATIONSHIP BETWEEN FEDERAL AND STATE/LOCAL ELECTRIC UTILITY REGULATION	8
A. Under *Nantahala*, FERC's rate order triggered the principle of federal preemption, removing prudence from the Council's purview	9
B. *MP & L*, reiterates the *Nantahala* prohibition of the Council's "prudence" review of NOPSI's practices	10
C. *Nantahala*'s limited exception to FERC preemption simply does not apply in this case	11
D. FERC is the only appropriate forum for the resolution of interstate cost allocation issues	13
CONCLUSION	14

TABLE OF AUTHORITIES

CASES:	Page
City of New Orleans v. FERC, 875 F.2d 903 (D.C. Cir. 1989), *cert. denied sub nom. Miss. v. FERC*, —— U.S. ——, 110 S.Ct. 1805 (1990)	5
Maine Public Utilities Comm'n v. Maine Yankee Atomic Power Co., cert. denied, —— U.S. ——, 59 U.S.L.W. 3527 (No. 90-1194, June 24, 1991)	13
Middle South Energy, Inc., Initial Decision, 26 FERC ¶ 63,044 (1984), *aff'd*, Opinion No. 234, 31 FERC ¶ 61,305 (1985), *decision on reh'g*, Opinion No. 234-A, 32 FERC ¶ 61,425 (1985)	5, 8, 12
Mississippi Industries v. FERC, 808 F.2d 1525 (D.C. Cir.), *vacated in part*, 822 F.2d 1104, *cert. denied sub nom. Arkansas Public Service Comm'n v. FERC*, 484 U.S. 985 (1987)	5
Mississippi Power & Light Co. v. Mississippi ex rel. Moore, 487 U.S. 354 (1988)	*passim*
Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953 (1986)	*passim*
New Orleans Public Service Inc. v. The Council of the City of New Orleans, 491 U.S. 350 (1989)	6
System Energy Resources, Inc., Opinion No. 292, 41 FERC ¶ 61,238 (1987); Opinion No. 292-A, 42 FERC ¶ 61,091 (1988)	5

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BRIEF OF EDISON ELECTRIC INSTITUTE AS AMICUS CURIAE IN SUPPORT OF PETITIONER

OPINION BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is reproduced in the Joint Appendix ("J.A.") to the Petitioner's Brief (J.A. 11-33) and is reported at 911 F.2d 993.

INTEREST OF EDISON ELECTRIC INSTITUTE

Edison Electric Institute (EEI)[1] is the association of the nation's investor-owned electric utility companies. Its members serve 96 percent of all customers served by

[1] EEI has obtained consent from Petitioner and Respondents to file this brief. EEI has filed those consents with the Clerk of the Court concurrently with the filing of this brief.

the investor-owned segment of the electric utility industry. They generate approximately 78 percent of all the electricity used in the country, and serve 74 percent of all ultimate electricity consumers in the nation.

The ability of many EEI members to provide reliable electric service under rates that are just and reasonable to their customers and to their shareholders depends heavily on a regulatory structure in which the Federal Energy Regulatory Commission (FERC), regulating rates for wholesale electricity transactions in interstate commerce, and state or local regulatory bodies, regulating rates for retail electricity sales, operate compatibly. Only FERC can provide the neutral forum which is essential to the resolution of regulatory disputes involving the interstate allocation of costs among affiliates of a utility system which operate in more than one state.

New Orleans Public Service Inc. (NOPSI), its operating company affiliates, and their common parent Entergy Corporation (formerly Middle South Utilities, Inc.) are all members of EEI. Together, they form a fully coordinated and highly integrated electric utility system which operates in four states. They are subject to regulation by FERC for wholesale electricity transactions, and by four state regulatory commissions and the Council of the City of New Orleans ("Council") for retail transactions. Thus, the operating affiliates of Entergy are subject to the rate regulation of six different jurisdictions. Their ability to provide reliable electric service is heavily dependent upon harmonious decisionmaking within that regulatory environment.

Most EEI members obtain some portion of their total electric supply through interstate wholesale transactions subject to rates regulated exclusively by FERC. Many of these companies, such as NOPSI, participate in multistate "power pools" with provision for reciprocal wholesale exchanges and sales. Others have invested in jointly-owned generation projects which supply power at wholesale to the joint-owners. Moreover, many utilities provide service in more than one retail jurisdiction.

This Court has recognized FERC's central role in the regulation of wholesale and interstate transactions, and has applied the doctrine of federal preemption in the context of electric utility regulation to ensure the continued ability of FERC to function as a neutral forum to resolve regulatory disputes regarding the allocation of costs among utilities in different states. *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) (retail rates of affiliated utilities must reflect FERC cost allocations) ("*Nantahala*"); *Mississippi Power & Light Co. v. Mississippi ex rel Moore*, 487 U.S. 354 (1988) (a FERC determination of the allocation of costs of a generating unit among affiliates of a utility system, where parties were afforded an opportunity to address the prudence of the transaction, preempts a subsequent attempt by a state regulatory commission to exclude or trap such costs from retail rates on grounds of imprudence) ("*MP & L*").[2]

This case raises again the question of whether a state or municipal regulatory body may use its retail ratemaking authority to effectively prevent a utility from recovering, thereby "trapping," a FERC allocation of wholesale costs among affiliated utilities serving different jurisdictions. This case arose from the same FERC allocation of wholesale costs among the operating companies of the Entergy Corporation system that this Court considered in *MP & L*.

The opinion of the court below threatens the foundation of the nation's interwoven electric utility regulatory process. This Court's decision in *MP & L* confirmed that there is a "bright line" between FERC and state or local jurisdiction under the Federal Power Act and the

[2] EEI submitted *amicus curiae* briefs supporting similar positions in each of those cases.

Supremacy Clause of Article VI of the Constitution, and that this federal preemption means that state and local regulatory commissions cannot "trap" the recovery of costs which were allocated among affiliates by FERC. The opinion of the court below violates this principal of preemption. It is apparent that this Court's recent *Nantahala* and *MP & L* decisions need to be reiterated.

EEI's members have a vital interest in the outcome of this case. Unrecovered—"trapped"—costs financially weaken utilities. This threatens the continued provision of one of the nation's most reliable and important energy resources by lessening the ability to purchase needed fuel, power, and equipment. If retail ratemaking authorities are permitted to evade explicit FERC allocation decisions, especially one which has only recently been affirmed by this Court, the ability of FERC to resolve allocation disputes will be destroyed. Electric utilities will thus be subjected to trapped costs with their potentially severe financial impacts whenever interstate allocation disputes arise. Therefore, EEI urges this Court to reverse the lower court's decision.

STATEMENT OF THE CASE

In view of the extensive Statement of the Case presented by NOPSI, and the fact that this Court has before been presented with the relevant FERC and Council orders, EEI will only briefly set forth the facts of this case. On behalf of the whole system, Entergy had one of its subsidiaries build Grand Gulf Station Unit No. 1 ("Grand Gulf"), a major base-load generating unit. The various operating companies each agreed to purchase part of Grand Gulf's output at wholesale for resale. The agreements governing these transactions were all filed at FERC for its review and approval.

FERC held lengthy and exhaustive proceedings concerning the allocation of Grand Gulf costs and just and reasonable rates for Grand Gulf power. During those

proceedings, the affected state and local jurisdictions participated fully and intensively. Each jurisdiction sought to minimize the share of Grand Gulf costs to be borne by its ratepayers. The City of New Orleans ("City") was an active participant. However, the City did not present—in fact, no party presented—a significant argument discussing the prudence of initiating or completing the Grand Gulf project.

After those proceedings, FERC determined that a just and reasonable wholesale rate for Grand Gulf power required a reallocation of costs to reflect system load responsibility.[3] NOPSI had been allocated 29.8% of Grand Gulf in the case as filed (*Middle South*, Initial Decision, note 3, *supra*). The City had argued that NOPSI's responsibility should be only 9% (*id.*). FERC determined that total system nuclear investment cost should be equalized, and so allocated 17% of those costs to NOPSI (*id.*).

Subsequent to FERC's decision, NOPSI sought authorization from the Council to recover its portion of the Grand Gulf costs through its retail rates. Ultimately, the Council disallowed $135-million of NOPSI's Grand Gulf costs. Shortly after the Council concluded its proceeding, this Court, in *MP & L*, enforced FERC's cost-allocation decision. At retail, this disallowance had virtually the same effect as would have occurred had FERC allocated Grand Gulf expenses to NOPSI in the 9% amount advocated by the City in the FERC proceedings.

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[3] *Middle South Energy, Inc.*, Initial Decision, 26 FERC ¶ 63,044 (1984), *aff'd*, Opinion No. 234, 31 FERC ¶ 61,305 (1985), *decision on reh'g*, Opinion No. 234-A, 32 FERC ¶ 61,425 (1985); *System Energy Resources, Inc.*, Opinion No. 292, 41 FERC ¶ 61,238 (1987); Opinion No. 292-A, 42 FERC ¶ 61,091 (1988). *See also Mississippi Indus. v. FERC*, 808 F.2d 1525 (D.C. Cir.), *vacated in part*, 822 F.2d 1104, *cert. denied sub nom. Arkansas Public Service Comm'n v. FERC*, 484 U.S. 985 (1987); *City of New Orleans v. FERC*, 875 F.2d 903 (D.C. Cir. 1989), *cert. denied sub nom. Miss. v. FERC*, —— U.S. ——, 110 S.Ct. 1805 (1990).

The Council held that NOPSI was "imprudent" during the construction period for failing to minimize the "losses" it should have anticipated as a result of FERC's rate determination and cost allocation (*e.g.*, J.A. 71-72, 170-171). This holding has the practical effect of requiring NOPSI to have expected an adverse FERC decision at the end of the construction period. The Council held that, given such a required expectation, NOPSI should, and could, have sold almost half of its Grand Gulf entitlement and responsibility, and purchased lower-cost electricity. *Id.* The Council never addressed the question of whether NOPSI could, under the system-wide contracts, have retained all of the hyopthetical benefit the Council was assuming that NOPSI could have acquired (*see id.*).

Significantly, FERC adopted the Administrative Law Judge's finding that Grand Gulf had been prudently constructed. 26 FERC at 65,112-113, *adopted*, 31 FERC at 61,666, *upheld*, 487 U.S. at 363. The City had never disputed that conclusion before FERC. *See MP & L*, 487 U.S. at 375. Thus, until after FERC's allocation and the Council's disallowance decision, NOPSI had no "losses" to mitigate.

On appeal, this Court ordered the U.S. Court of Appeals for the Fifth Circuit to hear this case in *NOPSI v. The Council of the City of New Orleans*, 491 U.S. 350 (1989) (the abstention doctrine of the Federal courts was not a sufficient basis for declining to hear this case) ("*NOPSI* III"). After *NOPSI* III, however, the Court of Appeals held that the Council's determination of imprudence was not "facially preempted" by FERC's opinion. The lower court reasoned that FERC had approved only the initial prudence of NOPSI's decision to participate in Grand Gulf. In fact, the lower court held that FERC did not assert jurisdiction to look at NOPSI's later prudence in continuing to participate once construction was "underway" (J.A. 25). Therefore, the lower

court concluded, *Nantahala* and *MP & L* did not preclude the Council from investigating NOPSI's ongoing prudence.

SUMMARY OF ARGUMENT

Only FERC can provide the neutral forum which is essential to the resolution of interstate disputes involving the allocation of costs among utilities operating in several jurisdictions. This Court has recognized FERC's central role in, and has applied the doctrine of federal preemption to, the context of electric utility regulation in order to ensure the continued existence of a coordinated regulatory structure. *Nantahala*, 476 U.S. 953; *MP & L*, 487 U.S. 354. However, the opinion of the court below violates this principle of preemption, endangering effective federal regulation of electric wholesale rates, in addition to threatening the financial health of electric utilities.

This Court should not countenance the Court of Appeals' failure to uphold a FERC allocation already reviewed and approved by this Court, any more than it can condone that action as taken directly by the Council. The Council's action is prohibited by *MP & L* and *Nantahala*. The Council's prudence argument is merely a transparent attempt to allow it to avoid or amend FERC's allocation. The City did not raise its argument before FERC when it had the chance—at least nine years after the commencement of construction. Further, during the retail rate proceeding, the Council did not engage in a truly separate evaluation of the prudence of any of NOPSI's overall practices such as, for instance, NOPSI's power supply. The Council merely repackaged the losing litigation position it had taken before FERC. The Court of Appeals decision must be reversed as not being in accord with *MP & L* and *Nantahala*, and the lower court must be instructed to overturn the Council's $135-million disallowance of NOPSI's Grand Gulf costs.

ARGUMENT

THE OPINION BELOW VIOLATES THE PREEMPTION DOCTRINE OF *NANTAHALA* AND *MP & L*, THREATENING THE PROPER AND WELL-ESTABLISHED RELATIONSHIP BETWEEN FEDERAL AND STATE/LOCAL ELECTRIC UTILITY REGULATION.

The Council's decision to disallow $135-million of NOPSI's Grand Gulf costs is prohibited by FERC's preemptive allocation of thos costs in the wholesale rate proceeding relating to Grand Gulf. Notwithstanding the erroneous conclusion of the court below, this Court's *Nantahala* and *MP & L* opinions make clear that the Council could not properly bar the recovery by NOPSI of any portion of the Grand Gulf costs FERC ordered NOPSI to pay. *Nantahala* and *MP & L* require that FERC's cost allocation be adopted by the Council as a prudent cost of power recoverable through NOPSI's retail rates.

FERC had already addressed many of the issues addressed by the Council, and those not addressed by FERC could have been raised by the City before FERC. The Administrative Law Judge addressed the prudence of Grand Gulf, and FERC adopted his findings (26 FERC at 65,112-113, *adopted*, 31 FERC at 61,666, *upheld*, 487 U.S. at 363). Under *MP & L*, this preempted any further discussion of the prudence of Grand Gulf construction.

The "prudence" argument of the Council in this case is no more to be given weight than the prudence argument was given weight in *MP & L*. Any other result would so undermine FERC's wholesale ratemaking authority as to render it a meaningless exercise any time there is a substantial interstate conflict—precisely contrary to the intent of Congress in passing the Federal Power Act. "The only appropriate forum for such a challenge is before [FERC] or a court reviewing [FERC's] order." *MP & L*, 487 U.S. at 375.

A. Under *Nantahala*, FERC's rate order triggered the principle of federal preemption, removing prudence from the Council's purview.

The lesson established by this Court in *Nantahala* is that a State's "historic police powers" do not permit a State commission to disallow a portion of a FERC-approved rate. Neither can a State avoid this prohibition simply by asserting that FERC's allocation had not been directly or indirectly attacked by the State's ruling. *See* 476 U.S. at 961-62. Thus, any attack on a utility's activities which have already been approved by FERC is an impermissible collateral attack on FERC's order.

In *Nantahala*, FERC had allocated low-cost TVA power between two affiliated power companies. 476 U.S. 961-62. The State commission later held that one of those utilities could have allocated more low-cost power to the other than was recognized by FERC's allocation. On that basis, in setting retail rates the State commission effectively disallowed recovery of a portion of the rate accepted by FERC, by assuming a higher allocation of low-cost power than that established by FERC. *Id.*

This Court recognized that the State's action would destroy FERC's ability to regulate wholesale transactions. The *Nantahala* Court held that "a state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price." 476 U.S. at 965. This Court stated with crystalline clarity that

> a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate . . . . Such a "trapping" of costs is prohibited.

476 U.S. at 970 (citation omitted). Once FERC has established a rate and allocation, a State may not under any guise revisit the determination of that rate or allocation, or in any way prevent the recovery of those costs.

B. *MP & L* reiterates the *Nantahala* prohibition of the Council's "prudence" review of NOPSI's practices.

The Council's position in this case is based on the holding that NOPSI at one and the same time could have been prudent—as found by FERC—to have obtained 17% of Grand Gulf through to the completion of that plant, but to have been imprudent—as found by the Council—in failing to sell a large portion of that share at some point during the plant's construction period. Such a position is contradictory in the least. Moreover, with the issue of Grand Gulf prudence having already been addressed by FERC through its Administrative Law Judge, it is too late to make such an argument.

In *MP & L*, the State supreme court had held that the State commission could review the prudence of the utility's management decisions regarding Grand Gulf. 487 U.S. at 368. One of the arguments in support of that position had been that the FERC opinion had never explicitly addressed prudence. *Id.* However, this Court rejected that line of reasoning as simply being another collateral attack on FERC's "plenary authority over interstate wholesale rates":

> Just as Nantahala had no legal right to obtain any more low cost TVA power than the amount allocated by FERC, it is equally clear that MP & L may not pay for less Grand Gulf power than the amount allocated by FERC.

487 U.S. at 374. The *MP & L* Court found that the investigation of Grand Gulf prudence was an impermissible collateral attack on FERC's order—the issue of prudence had been before FERC, and was therefore preempted by FERC's allocation of Grand Gulf costs. 487 U.S. at 374-375.

FERC's decision on the Grand Gulf prudence issue must be the sole, final and binding decision. The *MP & L* Court firmly stated that the

> reasoning that led to our decision in *Nantahala* applies with equal force here and compels the same conclusion—States may not alter FERC-ordered allocations of power by substituting their own determinations of what would be just and fair.

487 U.S. at 371. "States may not regulate in areas where FERC has properly exercised its jurisdiction . . ., without traversing matters squarely within FERC's jurisdiction." 487 U.S. at 374, 376.

It was improper for the Council to evaluate the prudence of NOPSI's continued participation in Grand Gulf. This case involves the very same generating plant and the same set of owners as in *MP & L*. And, just as in *MP & L*, the prudence review in this case was restricted by its own terms to Grand Gulf matters. Other prudence matters which may legitimately have been addressed by the Council were dealt with entirely separately.

As the *MP & L* Court said, the retail ratemaking body "may not enter an order 'trapping' the costs . . . mandated . . . under the FERC order allocating Grand Gulf power[,] or undertake a 'prudence' review for the purpose of deciding whether to enter such an order." 487 U.S. at 372. *MP & L* established that FERC has decided, and thereby preempted, the Grand Gulf prudence issue. Thus, there is nothing left for the Council to decide on that matter in this case.

C. *Nantahala*'s limited exception to FERC preemption simply does not apply in this case.

The limited exception to FERC preemption which can be found in *Nantahala* does not and cannot be utilized in this case. In *Nantahala*, this Court noted that "an increase in FERC-approved wholesale rates need not lead to an increase in retail rates" on a one-for-one basis, as the utility may have experienced cost "savings in other areas" not regulated by FERC. 476 U.S. at 967-968 (citation omitted). In this case, the Council's order did

not address any area other than that already preemptively addressed by FERC. Moreover, this Court has never held that the type of speculative retroactive ratemaking engaged in by the Council was equivalent to a cost-reduction recognizable under the *Nantahala* exception.

The sales required by the Council of NOPSI to reduce its costs were purely hypothetical in two ways. First, there has been no showing that NOPSI could have retained all of the benefit of such sales. In fact, there is every reason to conclude that NOPSI could not have retained the entirety of such a benefit. *See* 26 FERC at 65,148-149; J.A. 42-43, 49. Absent such a showing, it is inappropriate to attribute any portion, much less the entirety, of the benefit of these hypothetical transactions to NOPSI.[4]

Second, the Council's disallowance rests upon factual assumptions directly contrary to those made by FERC. The Administrative Law Judge found that the system reasonably concluded that all alternative sources of power were more expensive, and FERC adopted his conclusions. 26 FERC at 65,112-113, *aff'd*, Opinion No. 234, 31 FERC at 61,654-656. The Council, on the other hand, found that NOPSI could have obtained lower-cost power. Such a direct contradiction of a finding made during the course of a FERC wholesale proceeding cannot possibly result in the type of offsetting cost reduction referred to by this Court in *Nantahala*, at the very same time the Court also held that States could not relitigate issues decided before FERC, and that retail rate orders could not result in "trapping" FERC-approved costs.

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[4] The "evidence" upon which the Council relied in determining that there was an actual market for the Grand Gulf power the Council found NOPSI should have sold is not at all solid. *See* J.A. 71-72, 96-97.

D. FERC is the only appropriate forum for the resolution of interstate cost allocation issues.

Only FERC can provide the neutral forum which is essential to the resolution of interstate disputes involving the allocation of costs among utilities which operate in more than one state. This Court has recognized FERC's central role in, and has applied the doctrine of federal preemption to, the context of electric utility regulation to ensure the continued existence of a coordinated regulatory structure. *See Maine Public Utilities Comm'n v. Maine Yankee Atomic Power Co., cert. denied,* —— U.S. ——, 59 U.S.L.W. 3527 (No. 90-1194, June 24, 1991) (*"Maine Yankee"*) However, the opinion of the court below violates this principle of preemption by allowing unlimited State and local attacks on FERC-approved rates and allocations, such as was demonstrated in *Maine Yankee.* This endangers effective federal regulation of electric wholesale rates and threatens the financial health of electric utilities, thereby threatening the health of the nation's economy, as well.

Conflicting regulation resulting from State or local jurisdictions not agreeing to share all of the wholesale costs of electric energy and capacity will result in such costs not being recovered by utilities. Such "trapped" costs financially weaken utilities by seriously disrupting cash-flow and harm a utility's financial ratings, reducing a utility's ability to attract reasonably-priced capital, by reducing earnings and shaking investor and lender confidence in the assuredness of their return.

Initially, rates may stay lower, but in the long run, they will only increase. It was to prevent just such a short-sighted parochial form of regulation that Congress established the Federal Power Act giving FERC its plenary authority over wholesale electric rates. EEI stresses that the stable regulatory structure provided by federal regulation of interstate wholesale rates is better for the industry and thus, given the importance of elec-

tricity as an essential component of the country's infrastructure, better for the nation's overall economy.

CONCLUSION

This case is completely within the bounds of the issues settled by *MP & L* and *Nantahala*. Therefore, the decision of the Court of Appeals should be reversed, and this Court should direct the lower court to overturn the Council's $135-million disallowance of NOPSI's Grand Gulf costs.

Respectfully submitted,

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In The
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October Term, 1990

New Orleans Public Service, Inc.,
Petitioner
v.
The Council of the City of New Orleans, et al.,
Respondents

On Writ of Certiorari to the
United States Court of Appeals for the Fifth Circuit

BRIEF OF THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

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September 6, 1991

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TABLE OF CONTENTS

Table of Authorities	ii
Interest of the National Association of State Utility Consumer Advocates	1
Summary of Argument	2
Argument	3
Overview of the Delineation Between Federal and State Authority Over Electric Utilities	4
By Applying the Relevant Legal Principles to the Case At Bar, this Court Should Affirm the Decision of the Fifth Circuit	17
Conclusion	25

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Appeal of Sinclair Machine Products, 126 N.H. 822, 498 A.2d 696 (1985) — 5

Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission, 461 U.S. 375 (1983) — 23

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Kansas-Nebraska Natural Gas Co. v. State Corporation Commission, 4 Kan. App.2d 674, 610 P.2d 121 (1980) — 5

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Public Utilities Commission v. Attleboro Steam and Electric Co., 273 U.S. 83 (1927) — 22

Spence v. Smyth,
686 P.2d 597 (Wyo. 1984) 5

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AEP Generating Co.,
29 FERC ¶ 61,002 (1984) 13

AEP Generating Co.,
29 FERC ¶ 61,246 (1984) 13

AEP Generating Co.,
32 FERC ¶ 61,364 (1985) 13

AEP Generating Co.,
36 FERC ¶ 61,226 (1986) 13

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38 FERC ¶ 61,243 (1987), *rehearing denied*, 39 FERC ¶ 61,158 (1987) 14

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55 FERC ¶ 61,382 (1991) 9, 17

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50 FERC ¶ 61,251 (1990) 9, 16

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Kentucky Power Co.,
36 FERC ¶ 61,227 (1986) 14

Monongahela Power Co.,
39 FERC ¶ 61,350 (1987) 8, 9, 15

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27 FERC ¶ 61,080 (1984) 9, 24

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23 FERC ¶ 61,006 (1983) 9

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Southern Company Services, Inc.,
20 FERC ¶ 61,332 (1982) 9, 24

Southern Company Services, Inc.,
26 FERC ¶ 61,360 (1984) 9, 24

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28 FERC ¶ 61,349 (1984) 9

Statutes, Regulations & Rules

16 U.S.C. § 824 22

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1990

No. 90-1156

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Petitioner
v.
The Council of the City of New Orleans, *et al.*
Respondents

On Writ of Certiorari to the
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for the Fifth Circuit

BRIEF OF THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

Interest of the National Association of State Utility Consumer Advocates

The National Association of State Utility Consumer Advocates (NASUCA) files this brief as *amicus curiae* in support of Respondents. NASUCA members are the state-designated representatives of the interests of utility consumers in proceedings before state and Federal utility commissions. More particularly, NASUCA members represent retail electric consumers in 38 states and the District of Columbia.

NASUCA files this brief to urge the Court to affirm the decision of the United States Court of Appeals for the Fifth Circuit and to clarify the authority of state regulators to establish the intrastate rates of retail electric utilities. NASUCA submits this brief with the consent of the parties, and has filed written verification of such with the Clerk pursuant to Supreme Court Rule 37.3.

Summary of Argument

For over a decade, the Federal Energy Regulatory Commission (FERC) has held that, when it sets rates for a power transaction, it does not have the jurisdiction to determine the prudence of either the seller or the buyer in entering into the transaction. Rather, the prudence of the utilities' actions is examined by state regulators when retail rates are set for the utilities. FERC and this Court have recognized a limited exception to this rule when *both* the buyer and the seller are affiliates and are engaged in an integrated power pool. These principles are consistent with a long line of Federal and state cases and are well-grounded in the Federal Power Act. This Court should specifically adopt these principles.

In this case, however, New Orleans Public Service, Inc. (NOPSI) urges the Court to disregard these principles. NOPSI argues that state jurisdiction does not extend to transactions which involve unaffiliated, unpooled companies just because *one* of the parties is a member of an integrated pool of affiliates. This proposed limitation on state jurisdiction is contrary to FERC's consistent practice over the past decade. Moreover, it would have

serious consequences for the regulation of the electric utility industry. In particular, it would prohibit state regulators from determining the prudence of the particular mix of power resources used to meet a utility's *retail* requirements. Consequently, such matters would be required to be addressed by FERC. Neither FERC nor any court has held that FERC has such jurisdiction. Yet, this is the logical consequence of the arguments advanced by NOPSI before this Court. NASUCA submits, therefore, that this Court must reject these arguments and affirm the decision below of the Fifth Circuit.

Argument

In recent years, the state and Federal courts, and indeed this Honorable Court, have been increasingly called upon to determine the scope of Federal and state authority over the operations of retail electric and natural gas utilities.[1] NASUCA respectfully submits that this Court

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1 *See, e.g., Commonwealth Electric Co. v. Department of Public Utilities*, 397 Mass. 361, 491 N.E.2d 1035 (1986); *Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953 (1986); *Appalachian Power Co. v. Public Service Commission*, 812 F.2d 898 (4th Cir. 1987); *Kentucky West Virginia Gas Co. v. Pa. Public Utility Commission*, 837 F.2d 600 (3d Cir. 1988), *cert. denied*, 488 U.S. 941 (1988); *Mississippi Power and Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988); *Pennsylvania Power Co. v. Pennsylvania Public Utility Commission*, 127 Pa. Commw. 97, 561 A.2d 43, *aff'd per curiam*, --- Pa. ---, 587 A.2d 312 (1991), *petition for cert. pending at* Docket No. 90-1929; *Kansas Gas and Electric Co. v. State Corporation Commission*, Docket No. 64976 (Kan. App. June 29, 1990), *review denied*, 794 P.2d 1177 (Kan. 1990), *cert. denied*, --- U.S. ---, 111 S.Ct. 2824 (1991); *Maine Public Utilities Commission v. Maine Yankee Atomic Power Co.*, 581 A.2d 799 (Me. 1990), *cert. denied*, --- U.S. ---, 111 S.Ct. 2851 (1991).

should affirm the rights of states to regulate retail utility rates. Further, this Court should make it clear that the Federal Energy Regulatory Commission (FERC) does not regulate the prudence of utilities' wholesale purchasing and selling decisions, except in very limited instances. This case presents an opportunity for this Court to clarify the limitations on the jurisdiction of FERC.

Overview of the Delineation Between Federal and State Authority Over Electric Utilities

The briefs filed by NOPSI and the Solicitor (for the United States and FERC, cited herein as "FERC Brief") suggest that the relevant legal principles can be determined just by examining this Court's decision in *Mississippi Power and Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988). NASUCA respectfully submits that this is not correct. In order to fully understand the limitations on FERC's jurisdiction, it is necessary to place the *Mississippi Power* decision in the context of more than a decade of decisions from FERC and various Federal and state courts. As NASUCA discusses below, FERC itself has consistently recognized the limits on its jurisdiction since at least 1981. FERC's argument to this Court, however, represents a significant departure from the principles adopted by the courts and by FERC itself in its written decisions.

The overall delineation between Federal and state authority over the electric industry was perhaps best articulated by the Commonwealth Court of Pennsylvania in *Pike County Light and Power Co. v. Pa. Public Utility Commission*, 77 Pa. Commw. 268, 465 A.2d 735 (1983).

Since then, the principle enunciated in that case has been widely referred to as the "*Pike County* doctrine." Simply, in *Pike County*, the Pennsylvania court held that the state utility commission had jurisdiction to determine the reasonableness and prudence of a utility's wholesale purchasing decisions. The role of FERC was to determine the rate which the wholesale seller could charge. FERC, however, did not examine the wisdom of the buyer's decision; only the reasonableness of the rate which the seller could charge.

This delineation between Federal and state authority has been followed by several Federal and state courts[2] and by FERC itself. Indeed, even prior to the *Pike County* case, FERC had applied this same principle. In *Philadelphia Electric Co.*, 15 FERC ¶ 61,264 (1981), FERC held that its approval of a wholesale rate did not mean that the buyer was acting prudently in making the purchase. *Id.*, at 61,601. Moreover, in that case FERC also held that approval of the rate did not mean that the seller was acting prudently in making the sale. FERC thus recognized that its jurisdiction was limited to determining the

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2 *See, e.g., Appeal of Sinclair Machine Products*, 126 N.H. 822, 498 A.2d 696 (1985); *Commonwealth Electric Co. v. Department of Public Utilities*, 397 Mass. 361, 491 N.E.2d 1035 (1986); *Spence v. Smyth*, 686 P.2d 597 (Wyo. 1984); *Kansas-Nebraska Natural Gas Co. v. State Corporation Commission*, 4 Kan. App.2d 674, 610 P.2d 121 (1980); *Gulf States Utilities Co. v. Alabama Power Co.*, 824 F.2d 1465 (5th Cir. 1987); *Kentucky West Virginia Gas Co. v. Pa. Public Utility Commission*, 837 F.2d 600 (3d Cir. 1988), *cert. denied*, 488 U.S. 941 (1988).

reasonableness of the rate (and other terms and conditions) of the wholesale transaction. Its jurisdiction did not encompass an examination of the wisdom of either party in entering into that particular transaction (as opposed to the other options which might be available to them).

NASUCA recognizes, as did the Fifth Circuit, that the case at bar is not a classic "*Pike County*" case. That is, the dispute here is not over a wholesale purchasing decision made by a utility. FERC, however, has long recognized that the same principles on which the *Pike County* doctrine is based apply to FERC's jurisdiction over sellers of power. Further, these principles play an important role in understanding the delineation between Federal and state authority over the electric utility industry. Thus, these principles provide an important foundation from which to view this case.

In particular, the *Pike County* doctrine, as FERC and the courts have recognized, is necessary for the proper functioning of the regulatory process. FERC's role is to determine whether the price, and other terms and conditions, at which power is moving in interstate commerce are "just and reasonable." However, it is not the role of FERC to determine whether all of the potential buyers and sellers are making wise decisions given all of the options which are available to them.

For example, a utility may have several options to meet its need for power. It might be able to generate the power itself, use demand-management techniques to reduce the need for power, purchase power from several utilities, or purchase power from non-utility generators. Each of the potential sources of power will have different costs and will

be available under different terms and conditions. FERC must approve the reasonableness of the rates and terms only of the sales by other utilities. However, FERC cannot possibly examine all of the purchaser's supply and demand-related options and determine whether it has made a wise choice to satisfy its need for retail power in a particular way or from a particular source. That decision must be made by the state regulatory commissions in setting retail rates for the utility.

Similarly, as FERC held in *Philadelphia Electric*, it does not examine the reasonableness or prudence of the decision made by the seller. The selling utility also may have many options available to it (selling to various other utilities for varying lengths of time; using the power to serve retail load at lower cost; retiring older capacity; etc.). Thus, FERC appropriately has held that it is the role of the state commissions -- not FERC -- to assess whether the selling utility made a reasonable decision when it chose to make a particular sale.

The *Pike County* decision recognizes this distinction. There, the Pennsylvania court discussed the jurisdictional line between an examination of the costs of the seller (Orange & Rockland) versus the retail ratemaking treatment of the costs incurred by the buyer (Pike). The *Pike County* court thus held:

> The FERC focuses on Orange & Rockland to determine whether it is just and reasonable *for that company to charge* a particular rate, but makes no determination of whether it is just and reasonable *for Pike to incur* such a rate as an expense. The PUC, on the other hand, has no jurisdiction to analyze Orange & Rockland's

cost of service data and makes no determination as to the reasonableness for Orange & Rockland to charge its rates. The PUC focuses on Pike and its cost of service data to determine whether it is reasonable for Pike to incur such costs in light of available alternatives. So while the FERC determines whether it is against the public interest for Orange & Rockland to charge a particular rate in light of its costs, the PUC determines whether it is against the public interest for Pike to pay a particular price in light of its alternatives. The regulatory functions of the FERC and the PUC thus do not overlap, and there is nothing in the federal legislation which preempts the PUC's authority to determine the reasonableness of a utility company's claimed expenses. In fact, we read the Federal Power Act to expressly preserve that important state authority.

Id., 77 Pa. Commw. at 274-75, 465 A.2d at 738 (emphasis in original; footnote omitted).

The essence of the *Pike County* doctrine, then, is that if a utility has a choice when engaging in a wholesale transaction, the state commissions have jurisdiction to examine the reasonableness and prudence of the choices which the utility made. In particular, the states' power arises when the utility attempts to have *retail* rates set which reflect the effects of the wholesale transaction. (It should be noted that FERC has similar authority when the utility attempts to have *wholesale* rates set which reflect the effects of other wholesale transactions. *See Monongahela Power Co.*, 39 FERC ¶ 61,350, 62,095 (1987).)

FERC has consistently followed this reasoning over the decade which has passed since its *Philadelphia Electric* decision.[3] However, over the years, FERC and the courts (including this Court) recognized a corollary to the *Pike County* doctrine: When the utility has no choice in making a wholesale transaction, the *Pike County* doctrine does not apply (or, perhaps more accurately, the *Pike County* inquiry is not meaningful).

The prototypical example of a utility without a purchasing choice is one which is affiliated with a group of utilities that operate as an integrated power pool, and which FERC has ordered to make a particular purchase within the affiliated pool. This is precisely the issue which this Court decided in *Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953 (1986). There, the Court held that since FERC specifically ordered the utility to purchase only a certain amount of low-cost power, the utility had no choice but to pay for that amount of power and no more. The state commission was powerless to find that the utility had the option of purchasing more power than FERC had ordered it to purchase.

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3 *See, e.g., Southern Company Services, Inc.*, 20 FERC ¶ 61,332 (1982); *Pennsylvania Power and Light Co.*, 23 FERC ¶ 61,006 (1983); *Southern Company Services, Inc.*, 26 FERC ¶ 61,360 (1984); *Pacific Power and Light Co.*, 27 FERC ¶ 61,080 (1984); *Southern Company Services, Inc.*, 28 FERC ¶ 61,349 (1984); *Monongahela Power Co.*, 39 FERC ¶ 61,350 (1987); *Doswell Limited Partnership*, 50 FERC ¶ 61,251 (1990); *Commonwealth Atlantic Limited Partnership*, 51 FERC ¶ 61,368 (1990); *Iroquois Gas Transmission System Limited Partnership*, 52 FERC ¶ 61,091 (1990); *Boston Edison Co.*, 55 FERC ¶ 61,382 (1991).

Similarly, in *Mississippi Power and Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988), the Court held that a FERC order directing a utility to purchase a certain amount of high-cost power likewise prevented a state commission from finding that the utility had a choice not to purchase that power. In those cases, the Court clearly established the corollary to *Pike County*: Where FERC has ordered a utility to engage in a certain transaction, there is no choice and, thus, no meaningful *Pike County* review at the state level.

The import of *Mississippi Power*, though, is not that it establishes the *Nantahala* rule for high-cost power as well as for low-cost power. Rather, the significant question in *Mississippi Power* was a jurisdictional one: When does FERC have the jurisdiction under the Federal Power Act to order a utility to engage in a wholesale transaction? This jurisdictional question was addressed in some detail in Justice Scalia's concurring opinion and Justice Brennan's dissenting opinion (in which Justices Marshall and Blackmun joined).

Mississippi Power made it clear that FERC's jurisdiction over wholesale purchasers was extremely limited. *Mississippi Power* did not abolish the *Pike County* doctrine. Indeed, *Mississippi Power* did not really affect the *Pike County* doctrine itself. Rather, that case called on the Court to determine when FERC has jurisdiction to order a purchaser to make a particular purchase. The Court held that in the limited situation where the purchaser was a corporate affiliate of the seller and the parties were engaged in an integrated power pool, FERC had jurisdiction over the purchaser (and, thus, could order the purchaser to purchase a particular quantity of power). As Justice Scalia stated in his concurring opinion:

> After today, the battle will no longer be over who has jurisdiction, FERC or the States, to evaluate the prudence of a particular utility's *entering pooling arrangements with affiliated companies* for the sharing of electric generating capacity or the creation and wholesaling of electrical energy. FERC has asserted that jurisdiction and has been vindicated.

Mississippi Power, 487 U.S. at 383 (emphasis added).

Importantly, all of the Justices in *Mississippi Power* appeared to agree about the general applicability of the *Pike County* doctrine. Thus, the dissent began by citing *Pike County* and *Nantahala* for the general limits on FERC's jurisdiction, stating:

> FERC does not, however, have jurisdiction to determine whether it might be imprudent, given other purchasing options, for a retailing utility to *purchase* power at the FERC-approved wholesale rate. The state utility commissions have jurisdiction to determine, for example, that the retail utility does not need the power or could obtain power from other sources at a lower cost. Thus, although a state utility commission cannot decide that a retail utility should have bought wholesale power from a given source at other than the FERC-approved wholesale rate, it can decide that the utility should not have bought power from that source at all. In short, the reasonableness of charging a rate as a wholesaler is distinct from the reasonableness of incurring that charge as a purchaser.

Id., 487 U.S. at 385 (citations omitted; emphasis in original).

Where the dissent and majority differed was in their interpretation of the Federal Power Act to allow an exception to this general principle for affiliated power pools. The presence of an affiliated power pool raised two serious concerns. First, since the companies were affiliates, the transactions were not at arms' length, thereby possibly requiring review by a Federal intermediary. Second, the existence of an integrated power pool blurred the normal distinction between buyer and seller. Justice Brennan described this problem as follows:

> Interstate electricity pools, however, present special difficulties for the wholesale/retail division of jurisdiction because the "wholesale" transaction is from the pool to the utilities belonging to the pool, and thus the entities wholesaling the power are the same ones purchasing and retailing the power.

Id., at 386.

This distinction becomes important because FERC's jurisdiction is limited to matters affecting wholesale *rates*. In a normal transaction (between non-affiliated parties who are not engaged in an integrated power pool), the mere purchase of power does not affect the wholesale *rate* for power. However, when the transaction is not at arms' length and the parties are pooled (such that today's buyer might become tomorrow's seller and *vice versa*), the purchase does have a direct effect on the wholesale rate for power. This distinction was sufficient for a majority of the Court to agree with FERC that, under these limited facts, FERC has jurisdiction over the purchaser of power.

Indeed, what Justice Scalia appeared to find most persuasive was FERC's decision in another series of cases.

See id. at 378-79. While *Mississippi Power* had been working its way through the lower courts, FERC had issued a series of opinions in cases involving affiliates of the American Electric Power (or AEP) system. In those cases, FERC set forth a reasoned basis for its assertion of jurisdiction over wholesale purchasers where the buyer and seller were affiliates involved in an integrated power pool. FERC's reasoned decisions in those cases, however, stand in stark contrast to its wholly unsupported and unprecedented assertion of jurisdiction in its Brief to this Court. *See* pages 20 to 24, *infra*.

Initially, FERC had held that it would not consider the prudence of the purchasing members of AEP when setting rates for the selling member of AEP. *AEP Generating Co.*, 29 FERC ¶ 61,002 (1984); *AEP Generating Co.*, 29 FERC ¶ 61,246 (1984); *AEP Generating Co.*, 32 FERC ¶ 61,364 (1985). However, FERC subsequently concluded that the affiliated relationship of the parties and their integrated pooling arrangement had a direct effect on the reasonableness of the wholesale rates to be charged.

In *AEP Generating Co.*, 36 FERC ¶ 61,226 (1986), FERC began with a reaffirmation of the general principle that it does not have jurisdiction to examine the reasonableness or prudence of the purchaser's purchasing decision when setting rates for the seller, noting that "[u]nder narrow, non-pool circumstances, that view would remain sufficient and dispositive." *Id.*, at 61,550. FERC then explained, as follows, that the existence of an affiliated, integrated power pool presented a different jurisdictional question:

> [W]here, as here, the transaction involves affiliated, jurisdictional utilities, which are members of an integrated, interstate holding company arrangement, performing diverse functions on a coordinated basis, and particularly where differing interpretations are advocated concerning the parties' rights and obligations under the basic system agreements, the relevant issues may not be so readily segregated. Under these circumstances, more complex, interrelated questions arise and, whether one characterizes the questions as related to prudence, interpretation, or cost allocation, they are clearly matters most appropriately resolved by this Commission as part of its overriding authority to evaluate and implement all applicable wholesale rate schedules.

Id. FERC made similar statements in a companion order issued for another of the AEP companies the same day, *Kentucky Power Co.*, 36 FERC ¶ 61,227 (1986). *See also AEP Generating Co.*, 38 FERC ¶ 61,243 (1987), *rehearing denied*, 39 FERC ¶ 61,158 (1987).

In rejecting an attempt by the Kentucky Public Service Commission to alter provisions of the FERC-approved AEP agreements, the U.S. Court of Appeals for the Fourth Circuit described as follows the critical jurisdictional distinction that enabled FERC to regulate purchasers in an integrated pool of affiliated companies:

> Another reason the distinction *Pike County* drew between state and federal inquiries does not exist here is that, unlike the wholesale

> agreement at issue in *Pike County*, the [pooling agreement among the AEP companies] has no distinct "buyer" and "seller" of energy. *Pike County* had emphasized that FERC considers interstate agreements from the seller's perspective, while state commissions focus upon the in-state buyer. The nature of the [pooling agreement] and the AEP system is such that an affiliated utility could be at one time a receiver or "buyer" and at another time a supplier or "seller" of energy. FERC thus necessarily considered the fairness of the agreement from the perspective of all involved parties.

Appalachian Power Co. v. Public Service Commission, 812 F.2d 898, 904 (4th Cir. 1987).

In short, this Court's decision in *Mississippi Power*, as well as FERC's explication of its jurisdiction in the *AEP* cases, establish the limited jurisdiction of FERC over wholesale purchasers. FERC has such jurisdiction only where the purchaser is affiliated with the seller and they are members of an integrated power pool.

FERC has continued to recognize the validity of the *Pike County* doctrine (and the corresponding limits of its jurisdiction) after *Mississippi Power* and *AEP*. Initially, just one month after its final *AEP* order was issued, FERC issued an order which made it clear that *AEP* did not change the general rule (which is fully consistent with *Pike County*). In *Monongahela Power Co.*, 39 FERC ¶ 61,350 (1987), FERC was again faced, in the context of the seller's rate case, with a challenge to the prudence of a purchaser.

FERC declined to rule on the prudence of the purchaser, holding that because the purchaser and seller were not affiliates and were not members of an integrated power pool, "*we do not have jurisdiction* in this proceeding over the question of whether PEPCO [the purchaser] was prudent in entering into this transaction." *Id.*, at 62,095 (emphasis added).

Thus, immediately after its *AEP* decision, FERC made it absolutely clear that in the case of a transaction between unaffiliated companies, it did not have the jurisdiction to consider the prudence of the purchaser when setting the rate for the seller.

Recently, FERC has considered the effect of this Court's decisions in *Nantahala* and *Mississippi Power* and reached the same conclusion. Specifically, in *Doswell Limited Partnership*, 50 FERC ¶ 61,251 (1990), FERC held:

> Our finding that Doswell's rate is "just and reasonable" in this filing does not preclude this Commission or the Virginia Commission from examining the prudence of Virginia Power's purchase in a subsequent rate case. The Commission reaffirms its conclusion that the Supreme Court's decisions in *Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953 (1986), or subsequent cases, do not preclude state regulators from reviewing the prudence of a utility's purchasing decisions. While *Nantahala* held that "a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable," 476 U.S. at 966, the Court did not decide the issue whether a state agency can inquire into a utility's prudence in choosing to pay the FERC-approved wholesale rate of another supplier. *See also Kentucky West Virginia Gas Co. v. Pennsylvania Public Utility Comm'n*, 837 F.2d 600 (3rd Cir.), *cert. denied*, 109 S.Ct. 365 (1988); *Pike County Light and Power Co. v. Pennsylvania Public Utility Comm'n*, 465 A.2d 735, 737-738 (1983).

Doswell, at 61,758-59 n.18. *Accord Commonwealth Atlantic Limited Partnership*, 51 FERC ¶ 61,368, 62,249 n.84 (1990); *Iroquois Gas Transmission System Limited Partnership*, 52 FERC ¶ 61,091, 61,359 n.63 (1990); *Boston Edison Co.*, 55 FERC ¶ 61,382, 62,168 n.61 (1991).

NASUCA respectfully submits that this Court should specifically adopt the *Pike County* doctrine and its underlying principles. These principles then should be applied to the facts of this case to affirm the Fifth Circuit's decision.

By Applying the Relevant Legal Principles to the Case At Bar, this Court Should Affirm the Decision of the Fifth Circuit.

The case at bar raises a subsidiary question to that which the Court considered in *Mississippi Power*. *Mississippi Power* established that FERC has jurisdiction over members of an integrated pool of affiliated companies. Here, the Court is being asked to determine the *limits* on FERC's jurisdiction over affiliated members of an integrated power pool. This issue was not addressed by the Court in either *Nantahala* or *Mississippi Power*. The

Petitioner, as well as FERC and the other *amici curiae* supporting the Petitioner, seem to argue that FERC has plenary jurisdiction over members of such a pool. Thus, they have asked this Court to prevent a state regulatory commission (for that is the role which the City Council has *vis-a-vis* NOPSI under Louisiana law; *see* J.A. 15) from asserting jurisdiction over an important aspect of the retail rates of a utility solely because the utility is a member of an integrated power pool of affiliated companies.

There is no question, after *Mississippi Power*, that the City Council could not find that NOPSI had a choice in purchasing power from Grand Gulf. FERC had the jurisdiction to require NOPSI to purchase a specific portion of that plant and the state regulators cannot find that NOPSI had a choice in making that purchase. However, that is not what the City Council did here.

In this case, the City Council engaged in a very different inquiry. The City Council did *not* attempt to disturb the rate which NOPSI paid for power and did *not* attempt to alter the FERC-ordered allocation of power. Rather, it asked: What should NOPSI have done with this power? There is nothing in FERC's orders which says that NOPSI must use this power to serve its retail customers. There is nothing in FERC's orders which says that NOPSI was prohibited from selling the power from Grand Gulf at wholesale rather than at retail. So, the City Council engaged in an inquiry into the reasonableness and prudence of NOPSI's decision to use all of this power to serve its retail customers, rather than attempting to sell it to other (unaffiliated) utilities.

Based on substantial record evidence, the City Council found that NOPSI had the opportunity to sell a portion of this power to other utilities and that it imprudently failed to do so. The issue before this Court is whether this was a lawful exercise of the state's legal authority. Conversely, the question could be asked: Does FERC have the jurisdiction to determine whether it would be reasonable and prudent for NOPSI to sell power to another, unaffiliated utility? NASUCA submits that the answer to the latter question must be no. FERC has held for over a decade that it does not have the jurisdiction to examine the prudence of a seller's decision to sell to an unaffiliated, unpooled utility.

This case presents the flip-side of the question presented to FERC in *Philadelphia Electric*. There, the Pennsylvania Office of Consumer Advocate questioned the reasonableness and prudence of the selling utility's decision to sell a certain quantity of power to an unaffiliated utility at the rate being filed with FERC. FERC rejected this challenge, holding that it was a matter for the state utility commission to resolve when setting retail rates for the utility. FERC thus held:

> [W]e wish to make it clear that our decision to accept the contract for the initial period does not, in our view, bind us or the Pennsylvania Public Utility Commission to any particular treatment of these items in the cost of service for wholesale and retail requirements customers of PE [the selling utility].
>
> Further, our decision to accept the contract rate and service arrangement is not predicated on a determination that, over the initial term of the contract, PE could have done no better selling to someone else ... [W]e do not

> mean by this order to prejudge, for our own purposes or those of the respective state commissions, a determination of the prudence of either party in entering into this transaction.

Philadelphia Electric Co., 15 FERC, at 61,601. Thus, for the past decade, FERC has held that it would not consider the prudence of a seller's decision when setting rates for that sale.

FERC's decision in *AEP* and this Court's decision in *Mississippi Power* did not change this. FERC and this Court have made it clear that those decisions are limited to transactions among affiliated companies which are engaged in an integrated power pool. Indeed, as noted above, FERC has specifically stated that it will continue to rely on the *Pike County* doctrine in cases where the transaction is not between pooled affiliates. *See, e.g., Monongahela Power Co., supra; Doswell Limited Partnership, supra.*

The brief of FERC in the case at bar recognizes this limitation on its jurisdiction. Thus, for example, FERC describes its jurisdiction "over wholesale transactions among members of an integrated public utility holding company system." FERC Brief at 11. This is an accurate statement of FERC's jurisdiction. Yet, FERC and NOPSI attempt to expand this authority into jurisdiction over transactions which are not "among members of an integrated public utility holding company system." It is particularly difficult to reconcile FERC's position given its acknowledgment that NOPSI has "some measure of individual autonomy" over its operations. *Id.* at 17, n.7. If NOPSI has the right to operate autonomously (that is, it is not restricted to only dealing with its affiliates), then how can FERC assert that it has jurisdiction over non-affiliated aspects of NOPSI's operations?

As stated by the Court in *New Orleans Public Service, Inc. v. Council of New Orleans*, 491 U.S. 350 (1989):

> The Council has not sought directly to regulate interstate wholesale rates; nor has it questioned the validity of the FERC-prescribed allocation of power within the Grand Gulf system, or the FERC-prescribed wholesale rates; nor has it reexamined the prudence of NOPSI's agreement to participate in Grand Gulf 1 in the first place. Rather, the Council maintains that it has examined the prudence of NOPSI's failure, after the risks of nuclear power became apparent, to diversify its supply portfolio, and that finding that failure negligent, it has taken the normal ratemaking step of making NOPSI's shareholders rather than the ratepayers bear the consequences. *Nothing in this is directly or even indirectly foreclosed by the federal statute, the regulations implementing it, or the case law applying it.*

Id., at 367 (emphasis added).

Thus, this Court cannot sustain the position of NOPSI and FERC that FERC alone has jurisdiction to determine whether a utility should have sold power to an unaffiliated, unpooled utility. This position is directly contrary to FERC's consistent practice over the past decade. If FERC lacks jurisdiction to consider the prudence of sales to unaffiliated companies, then surely it also must lack jurisdiction to consider the prudence of the *failure* to sell to unaffiliated companies.

The fact that *one* of the utilities to the transaction is a member of an integrated power pool of affiliates is not sufficient for FERC to have jurisdiction. FERC's jurisdiction exists only when *both* parties to the transaction are affiliated with each other and are *both* members of the same integrated power pool. Otherwise, the mere entry into a minor pooling arrangement with an affiliate would automatically exempt all of the utility's wholesale decisions from state review.

For example, a utility with a retail demand of 5000 megawatts could enter into a pooling arrangement with a small affiliate for 100 megawatts. FERC would have ordered the utility to buy 100 megawatts of power from its small affiliate. Would this then exempt the remaining 4900 megawatts of power from review at the retail rate level? If this question were answered in the affirmative, then FERC would have to exercise jurisdiction over the entirety of the utility's operations -- a matter over which FERC and numerous courts have held that FERC does not have jurisdiction.

Further, it must be recalled that the very purpose of the Federal Power Act was to eliminate the "regulatory gap" which had developed as a result of the Court's decision in *Public Utilities Commission v. Attleboro Steam and Electric Co.*, 273 U.S. 83 (1927). This "regulatory gap" had allowed certain power transactions to remain unregulated by either the states or the Federal government. Congress expressed a clear intention to close that gap. The Federal Power Act gives certain, specifically defined, powers to the Federal government and leaves all other matters to the states. *See* 16 U.S.C. § 824. This Court has since made it clear that it would not sanction an

interpretation of the Federal Power Act which would allow a power transaction to be unregulated. *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375 (1983).

Yet, NOPSI's contention before this Court would create just such a gap in the regulation of power sales. NOPSI asserts that just because it is a member of a pool of affiliated companies, then all of its wholesale activities -- whether with its affiliates or with others -- are exempt from review at the retail level. This cannot be sanctioned by this Court, particularly since FERC itself has held that it does not have the jurisdiction to review transactions between unaffiliated, unpooled companies.

Thus, the relief requested by NOPSI would have one of two effects. Either it would give FERC jurisdiction over the prudence of all wholesale buyers and sellers (without regard to their affiliation or pooling arrangements), or it would create a "regulatory gap" in which certain transactions would not be regulated by either the state or Federal commissions. NASUCA submits that neither result is in the public interest or consistent with the Federal Power Act.

Moreover, FERC's reference to previous cases where it has considered the prudence of utilities' off-system sales decisions does not lead to a different conclusion. FERC Brief at 18 n.9. The cases cited by FERC were cases where it was setting *general wholesale rates for the selling utility*. In setting those rates, FERC necessarily had to determine whether or not the utility had acted reasonably and prudently in procuring the power which it would be selling at wholesale. These cases did *not* involve affiliated pooling arrangements, power allocations, or other *specific* power transactions. They are simple rate cases.

Indeed, it is instructive to note that FERC has drawn a clear distinction between the scope of its jurisdiction when setting general wholesale rates and its jurisdiction over particular power transactions. For example, in the *Monongahela Power* case FERC expressly stated that it did not have jurisdiction over the purchaser *when setting rates for the seller*. However, if the purchaser attempted to pass those costs on through *its wholesale rates*, then FERC would have jurisdiction over the prudence of the utility's purchasing decisions. Specifically, FERC held:

> [W]e do not have jurisdiction in this proceeding over the question of whether PEPCO was prudent in entering into this transaction. We may consider that question only in a rate proceeding in which PEPCO seeks to pass through the costs of the ... purchase to wholesale ratepayers.

Id., 39 FERC at 62,095. *Accord Southern Company Services, Inc.*, 20 FERC ¶ 61,332 (1982); *Southern Company Services, Inc.*, 26 FERC ¶ 61,360 (1984); *Pacific Power and Light Co.*, 27 FERC ¶ 61,080 (1984).

Thus, the cases cited by FERC do not support its assertion of jurisdiction in this case.

In summary, NASUCA respectfully requests this Court to affirm the right of state utility commissions to regulate the retail rates of electric utilities. This state power must include an examination of all of the power-supply alternatives reasonably available to the retail utility. While FERC has jurisdiction over transactions among affiliates engaged in an integrated power pool, that jurisdiction does not extend to unaffiliated transactions of such pool members. This Court should so hold and should affirm the opinion below by the Fifth Circuit.

CONCLUSION

The decision of the United States Court of Appeals for the Fifth Circuit should be affirmed. That decision is fully consistent with decisions of FERC, other Federal and state courts, and this Court, as well as the statutory limits placed on FERC's jurisdiction.

Respectfully submitted,

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TABLE OF CONTENTS

Page

INTEREST OF AMICUS CURIAE..... 1

SUMMARY OF ARGUMENT..... 7

ARGUMENT..... 12

THE CITY COUNCIL'S JURISDICTION TO HOLD NOPSI ACCOUNTABLE FOR ITS FAILURE TO REDUCE THE RISK OF GRAND GULF POWER IS NOT PREEMPTED.....15

A. Filed Rates.....21

B. Trapped Costs.....25

C. NOPSI's Obligation to Purchase and Not Resell Its Grand Gulf Power.....28

CONCLUSION.....38

TABLE OF AUTHORITIES

Cases: Page

Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission, 461 U.S. 375 (1983)..13,16

Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989).....13-14,33

Federal Energy Regulatory Commission v. Mississippi, 456 U.S. 742 (1982).....33

Mississippi Power & Light Co. v. Mississippi ex rel. Moore, 487 U.S. 354 (1988).....5,17

Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953 (1986).....5,22,23,24

New Orleans Public Service, Inc. v. Council of City of New Orleans, 491 U.S. 350 (1989) ("NOPSI III").....passim

Ohio Power Co. v. FERC, 880 F.2d 1400 (D.C. Cir. 1989), rev. sub nom. Arcadia v. Ohio Power Co., 498 U.S. ___, 112 L.Ed.2d 374 (1990).....27

Pike County Light & Power Co. v. Pennsylvania Public Utility Commission, 465 A.2d 735 (1983).....30

Administrative Proceedings:

Notice of Proposed Rulemaking, Regulations Governing Bidding Programs, IV F.E.R.C. Stats. & Regs. para. 32,455, 53 Fed. Reg. 9324 (1988).....35

Notice of Proposed Rulemaking, Regulations Governing Independent Power Producers, IV F.E.R.C. Stats. & Regs. para. 32,456, 53 Fed. Reg. 9327 (1988).....34

Miscellaneous:

Griggs, Competitive Bidding and Independent Power Producers: Is Deregulation Coming to the Electric Utility Industry?, 9 Energy L.J. 415 (1988).....35

Tierney, Pre-Approval of Resources: A New Direction for Regulation in Massachusetts, Electricity Journal 26 (Dec. 1990).....31

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1990

No. 90-1156

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS,
ET AL.,
Respondents.

On Writ of Certiorari To The United States
Court of Appeals For The
Fifth Circuit

BRIEF OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

INTEREST OF AMICUS CURIAE

The National Association of Regulatory Utility Commissioners (NARUC) submits this brief as amicus curiae urging affirmance due to the substantial harm reversal of the decision below may have upon the regulation

of public utilities by its member State regulatory commissions. The NARUC files this brief with the written consent of the Petitioner and the Respondents, which have been filed separately with the Clerk.

The NARUC is a quasi-governmental nonprofit organization founded in 1889. Within its membership are the governmental bodies of the fifty States, and the governmental agencies of the District of Columbia, Puerto Rico, and the Virgin Islands engaged in the regulation of utilities and carriers. The Council of the City of New Orleans, Respondent herein, is an Associate Member of the NARUC. The mission of the NARUC is to serve the public interest by seeking to improve the quality and effectiveness of public regulation in America.

More specifically, the NARUC contains State and local officials charged with the duty of regulating natural gas, electric and

communications utility companies operating within their respective jurisdictions. As such, these officials have the obligation to assure the establishment and operation of utility companies which serve the public interest. This means that State and local regulators must, under law, seek to ensure that dependable and safe utility service is provided consumers at rates which are just, reasonable and nondiscriminatory.

In the decision herein under review, the United States Court of Appeals for the Fifth Circuit affirmed a decision of the United States District Court, Eastern District of Louisiana, rejecting Petitioner's claim that the Council of the City of New Orleans' ("City Council" or "Council") decision fixing the retail rates it may charge its customers was preempted by earlier decisions of the Federal Energy Regulatory Commission (FERC or the

Commission).[1] Petitioner New Orleans Public Service Inc. (NOPSI), a utility selling electricity to retail consumers in the City of New Orleans, has appealed the Fifth Circuit's decision to this Court on the ground that the court below erred by rejecting NOPSI's argument that a Federal Energy Regulatory Commission (FERC) ratemaking order applicable to a wholesale sale or allocation of electricity preempts a State or local commission decision that the power acquired by the retail utility pursuant to that order should have been resold is facially preempted. Specifically, NOPSI contends that the City Council's

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[1] The decision of the Fifth Circuit appears at pages 2A-24A of the Appendix to the Petition for Writ of Certiorari, and, as revised by the Court of Appeals on February 8, 1991, appears at pages 11-33 of the Joint Appendix. This decision has been reported at 911 F.2d 993. The decision of the District Court, which is unreported, appears at pages 26A-32A of the Appendix of the Petition for Writ of Certiorari. Subsequent reference will be made to these decisions as they appear therein in this form: Cert. App. at ___, or J.A. at ___.

decision finding the utility imprudent for failing to resell wholesale power generated by the Grand Gulf nuclear power station and allocated to it by FERC is beyond the City Council's jurisdiction under this Court's decisions in Nantahala,[2] Mississippi Power & Light,[3] and a recent decision involving the same parties, NOPSI III.[4] The Council's order in no way questions the FERC allocation of power to NOPSI, or the FERC-set rate, but rather sets retail rates based on off-setting revenues that NOPSI said it could obtain, but did not, through off-system sales.

If adopted by this Court, Petitioner's

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[2] Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953 (1986).

[3] Mississippi Power & Light Co. v. Mississippi ex rel. Moore, 487 U.S. 354 (1988).

[4] New Orleans Public Service, Inc. v. Council of City of New Orleans, 491 U.S. 350 (1989). This case is known as NOPSI III due to earlier litigation involving these parties.

argument would substantially and seriously disrupt State regulatory systems in an area of State concern recognized by the Court in its past decisions as a vital interest: State regulation of the retail rates and services of electric utilities. Reversal of the Fifth Circuit's decision could greatly restrict the ability of State and local regulatory commissions to ensure that retail utilities which are operating affiliates of public utility holding companies operate in an efficient manner and do not force their ratepayers to bear the risks of negligent or imprudent utility decisionmaking. The protection of State and local jurisdiction in these circumstances is especially important at this time -- a period in which this vital industry is undergoing profound structural and regulatory reform as a result of the implementation of procompetitive State and Federal policies. Accordingly, the NARUC's interest in addressing the

impact of Petitioner's arguments on the jurisdiction, practices and procedures of its member commissions is strong, compelling its participation in this case.

SUMMARY OF ARGUMENT

In their respective arguments to this Court, both NOPSI and the United States and FERC, as joint amici in support of NOPSI, assert that there can be no State or local regulation which affects the recovery in retail rates of the costs of the Grand Gulf plant, essentially because FERC's exclusive jurisdiction over wholesale rates leaves nothing to be regulated at the retail level. Rather, so the argument goes, the City Council, and other similarly situated State and local regulatory bodies, must mechanically pass through wholesale power costs in retail rates, even if they have determined that the retail utility assigned

these costs could have accepted its allocated share, but taken actions to reduce the exposure of its ratepayers to the economic distress and dislocation these costs will cause. Not only are retail regulatory bodies bound by FERC's determination of the level and allocation of the costs of wholesale power, they are also apparently without jurisdiction to take any action whatsoever that would affect the retail utility's recovery of these costs in its rates to the residential, commercial and industrial consumers it is privileged to exclusively serve under the protection of State and local franchise statutes and regulations -- even where, as here, neither the allocation nor the FERC-set wholesale rate are disturbed or even questioned.

In point of fact, in making these arguments, NOPSI and its supporters seek this Court's affirmance of a regulatory regime that would force State and local

commissions to charge retail ratepayers for supply options that are not necessarily the least costly available to meet ratepayer demands for power, even if other options are available that are equally consistent with the FERC's wholesale rate and allocation order. In essence, their argument for facial preemption is that the mere issuance of an FERC wholesale rate or allocation order, at least in the context of a public utility holding company system, automatically requires State and local regulators to permit the dollar-for-dollar recovery of the costs assigned by the FERC order from retail ratepayers, even if the retail utility's actions or inactions were demonstrably imprudent or negligent. In other words, the mere existence of a FERC order forecloses any State or local retail ratemaking determination which reduces retail rates below the levels that would result from an automatic passthrough of

these wholesale costs.

In its decision in NOPSI III, however, the Supreme Court rejected Petitioner's arguments that the City Council's ruling at issue in this case was "facially preempted" by the FERC's exercise of jurisdiction over the wholesale rate impact of the Grand Gulf power plant. 491 U.S. at 367. Indeed, this Court remanded this very case for the purpose of conducting a "factual inquiry" into the City Council's decisionmaking process. If, as NOPSI and its supporters apparently believe, there were no independent State or local jurisdiction to engage in such decisionmaking, the Court's remand would clearly have been unnecessary, since there would have been no facts worth finding.

Despite the remand, however, there are no new facts. This case comes to this Court in the same posture as NOPSI III, with the additional weight of the decisions of the

District Court and Court of Appeals which found that the City Council acted within its lawful jurisdiction. Petitioner's rejected claim of "facial preemption" embedded in the NOPSI III abstention litigation -- that FERC and only FERC can determine the ultimate recovery of Grand Gulf costs from NOPSI's retail ratepayers -- differs in no material respect from its claim in this case.

Throughout their briefs, NOPSI and its supporters trumpet the need for a "neutral forum" to decide power supply, pricing, and allocation issues affecting two or more States. Clearly, the Commission is authorized to play such a role, but the argument has no application here because the decision here does not affect two or more States, nor does it shift costs to other States. However, it is not the case that FERC's jurisdiction to regulate wholesale power sales, including the establishment of a "filed rate," serves to preempt or

otherwise foreclose the ability of State and local commissions to reach reasoned decisions concerning local utility decisions which underlie the rates and their effects upon retail utility consumers. Moreover, this alleged "neutrality," which is not at issue here, cannot serve to expand FERC's jurisdiction beyond that authorized by Congress, which is precisely the result NOPSI and the Government seek here.

ARGUMENT

As this Court recognized in NOPSI III, the City Council "has a substantial, legitimate interest in regulating intrastate retail rates." NOPSI III, supra, 491 U.S. at 365. Indeed, there the Court noted that NOPSI, once again the Petitioner in this case, did not deny "that the State has an interest affirmatively protected by federal law in conducting proceedings to set intrastate retail rates." Id. at 366. This

statement is entirely consistent with statements in the Court's earlier decisions that "the regulation of utilities is one of the most important of the functions traditionally associated with the police power of the States." Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission, 461 U.S. 375, 377 (1983). Indeed, the Court has recently reaffirmed the constitutional principle that in discharging this "important function," State and local regulators have broad authority to "decide what rate-setting methodology best meets their needs in balancing the interests of the utility and the public." Duquesne Light Co. v. Barasch, 488 U.S. 299, 316 (1989). Therein, the Court observed that retail ratemaking is a difficult undertaking, requiring the consideration of a multitude of factors: "The economic judgments required in rate proceedings are often hopelessly complex and

do not admit of a single correct result." Id. at 314.

The issue in this case is whether, when making these "complex economic judgments," State and local regulatory commissions are precluded from discharging their "most important function" merely because the FERC has allocated wholesale power costs to the local utility. Petitioner and its supporters contend that wholesale power costs assigned a retail subsidiary by the FERC must be automatically recovered dollar-for-dollar from retail ratepayers even when it has been shown that the retail subsidiary failed to take actions to reduce the impact of those costs on its consumers without upsetting the allocation and without intercompany consequences. The NARUC respectfully submits that despite FERC's supervision of wholesale power sales, this Court must find that State and local regulators retain their historic

jurisdiction "affirmatively protected by federal law. . .to set intrastate retail rates." 491 U.S. at 366.

THE CITY COUNCIL'S JURISDICTION TO HOLD NOPSI ACCOUNTABLE FOR ITS FAILURE TO REDUCE THE RISK OF GRAND GULF POWER IS NOT PREEMPTED

In reviewing NOPSI's facial preemption claim, this Court does not write on a clean slate. In NOPSI III, the Court found no "facial preemption" of the City Council's jurisdiction over the passthrough of NOPSI's share of the costs of the Grand Gulf plant:

> The Council has not sought directly to regulate interstate wholesale rates; nor has it questioned the validity of the FERC-prescribed allocation of power within the Grand Gulf system, or the FERC-prescribed wholesale rates; nor has it examined the prudence of NOPSI's agreement to participate in Grand Gulf 1 in the first place. Rather, the Council maintains that it has examined the prudence of NOPSI's failure, after the risks of nuclear power became apparent, to diversify its supply portfolio, and that finding that failure negligent, it has taken the normal ratemaking step of making NOPSI's shareholders rather than the ratepayers bear the consequences. Nothing in this is directly or even

> indirectly foreclosed by the federal statute, the regulations implementing it, or the case law applying it.
>
> NOPSI III, 491 U.S. at 367 (emphasis added)

The issue underlying the City Council's review of NOPSI's retail rates was the "normal" regulatory inquiry as to whether the utility had the obligation to take actions to sell power, once assigned it by the FERC, in order to discharge the responsibility it had to deal with the growing risks of the project at the time options were available to reduce those risks. However, NOPSI[5] and the United

[5] According to NOPSI, the only role State and local regulatory commissions may play in cases such as this is to assert their rights as litigants in FERC proceedings under section 205 of the Federal Power Act. Once those proceedings are complete, including subsequent judicial review of the FERC rate order, then the retail regulators are allegedly bound with respect to retail cost passthrough issues. Pet. Br. at 24-28. Of course, under such a regime, retail regulators, exercising one of "the most important of the functions traditionally associated with the police power of the States" (Arkansas Electric, supra, 461 U.S. at 377), become just one more litigant with no greater standing than the retail utility companies they are charged to regulate.

States[6] have framed the issue as whether State and local regulators have any jurisdiction to take any action with respect to a FERC wholesale allocation other than simply passthrough the costs in retail rates. Relying on MP&L, these parties assert that the Council is unquestionably foreclosed from determining this question, and further, that the Fifth Circuit's finding, relying on this Court's conclusions in NOPSI III, that not all elements of the utility's behavior were beyond the City Council's purview is erroneous.

[6] According to the United States and the FERC, there is no set of regulatory findings or circumstances that would enable a retail regulatory commission to affect the recovery in retail rates of wholesale power costs pursuant to a FERC-approved allocation. Govt. Br. at 13-16. "Just as FERC had exclusive jurisdiction to consider the contention that MP&L acted imprudently, it also had exclusive jurisdiction to consider the Council's prudence theory." Id. at 15.

Contrary to these claims, the Fifth Circuit's decision faithfully reflected this Court's opinion in NOPSI III, finding that under MP&L "there were several things the Council was not entitled to do in the prudence inquiry." J.A. at 23. The court below then engaged in searching inquiry of "exactly what the Council did," and relied on this Court's "characterization" of the Council's actions in NOPSI III, supra at 14-15, to conclude that the Council's order "is not facially preempted." J.A. at 24-26.[7]

NOPSI finds the Fifth Circuit's reliance on this Court's NOPSI III

[7] The Fifth Circuit found that the Council had not strayed into forbidden territory by questioning NOPSI's decision to participate in Grand Gulf, or challenging FERC's determination of the price or allocative shares of the Grand Gulf power. J.A. at 23-24. Rather, the court below found that the Council had acted in an area that FERC had not addressed -- NOPSI's behavior as wholesale purchaser and potential reseller "once the Grand Gulf project was underway." Id. at 25. Again, relying on NOPSI III, the Court of Appeals correctly found no facial preemption under this line of reasoning.

"characterization" to be "inexplicable," and further asserts that the meaning of NOPSI III is so mysterious that "only this Court can know what it meant in this passage from NOPSI III." Pet. Br. at 36. With all due respect, the Court's statement in NOPSI III, 491 U.S. at 367, that "[n]othing [in the Council's order] is directly or even indirectly foreclosed by the federal statute, the regulations implementing it, or the case law applying it" is both pellucid and sensible.[8] It means that the City

[8] It is NOPSI's argument that FERC's "orders" facially preempt the City Council that is inexplicable. Pet. Br. at 36 (emphasis in original). Throughout its brief, NOPSI argues that once FERC issued its wholesale decisions, the City Council had no jurisdiction to take any action which denied or interfered with its right to passthrough the Grand Gulf costs. If this is true, the nature or content of the FERC "orders" defining or allocating those wholesale costs is irrelevant. Their mere existence is enough to foreclose retail regulatory authority. Clearly, this Court knew that these orders existed, but characterized the City Council's actions in NOPSI III in terms of the preemptive effects of the law, i.e. the statute, regulations and case law which define the respective

Council's action in finding NOPSI imprudent for its failure "to diversify its supply portfolio," if supported by evidence, is not preempted by the Federal Power Act, the FERC's regulations, or administrative and judicial decisions interpreting federal law. More importantly, this statement must mean that there are legitimate areas in which retail regulatory commissions can lawfully exercise their jurisdiction, even in the case of wholesale power acquisition by a retail affiliate of a holding company. Stated differently, the Court's statement in NOPSI III means that both NOPSI and the United States are wrong in asserting that retail regulators must in every case establish a retail rate that is the equivalent of a dollar-for-dollar recovery of FERC-regulated wholesale power costs in retail rates, even if there are legitimate offsets to be considered.

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roles of State and Federal regulators.

A. Filed Rates

Accordingly, NOPSI and the United States' reliance on the "filed rate doctrine"[9] and the issue of "trapped costs"[10] as grounds for federal preemption of the Council's jurisdiction is unavailing. With respect to the "filed rate doctrine", there has been no showing, nor could there be, that the Council has interfered with NOPSI's obligation to pay for its share of Grand Gulf power at the FERC-determined rate.[11] As a practical matter, the "filed

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[9] Pet. Br. at 29-30.

[10] Govt. Br. at 14-15.

[11] The United States admits as much: "...the Council's prudence order does not relieve NOPSI of the duty to pay for power it draws from the MSU system at the rates prescribed by FERC's order." Govt. Br. at 21. Contrary to the Government's conclusion, the fact that the "filed rate" remains intact distinguishes this case from MP&L, wherein the Mississippi Supreme Court's decision constituted, in the view of the Fifth Circuit, a finding "on MP&L's purported imprudence in deciding to participate in Grand Gulf in the first place," an issue of federal jurisdiction. J.A. at 23. Here, the Council has assessed

rate" argument confuses two related, but separate issues. Under the filed rate doctrine, NOPSI is obligated to pay for Grand Gulf power, both as to price and quantity, as FERC's rulings require. In essence, NOPSI is bound in a quasi-contractual sense to its obligation to purchase and pay.

What NOPSI does or does not do with the Grand Gulf power once purchased is an entirely different issue, one step removed from its wholesale purchase obligation, for which the FERC-determined filed rate is immaterial. NOPSI denies any such distinction, relying on this Court's decision in Nantahala, supra, for the proposition that FERC-established wholesale rate levels "must be given binding effect by

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no imprudence remedy on similar grounds, and has assumed that the "filed rate" must stand. The issue here is whether NOPSI was negligent in failing to resell, irrespective of its obligation to purchase Grand Gulf power.

state utility commissions determining intrastate rates."[12] As a matter of logic, NOPSI's argument appears to be that once the federal agency establishes a rate and a quantity of power to be purchased, any subsequent action by the purchasing utility, as directed or regulated by its retail regulator, to resell the power or service acquired is preempted, even if the utility continues to purchase at the filed rate.

In practice, Petitioner's "filed rate" argument would effectively insulate utility purchasers of regulated goods and services from any obligation to manage their businesses prudently. It is entirely inconsistent with the history of management of the Middle South System, where the retail utilities have been bought and sold power sources through the exercise of prudent management responsibilities. Petitioner's

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12 Pet. Br. at 29, citing Nantahala, 476 U.S. at 966.

sweeping argument would do more to insulate their managers from their public responsibility than any claim previously advanced by any public utility holding company. In short, this argument would become a jurisdictional shield to protect management from its ongoing need and obligation to act prudently.

Clearly, this Court's ruling in Nantahala that States may not find FERC-approved rate levels to be unreasonable, 476 U.S. at 966, cannot bear the weight that NOPSI gives it. Logically and practically, NOPSI's acquisition of bulk power supplies under a FERC-regulated regime, and its subsequent actions at the retail level are distinct issues which the Fifth Circuit quite properly held were within the City Council's jurisdiction. J.A. at 24-26.

B. Trapped Costs

NOPSI's reliance on "trapped costs" also proves too much, as does the United States' argument that the City Council is "foreclosed" from disallowing FERC-approved costs in retail rates. Pet. Br. at 29; Govt. Br. at 14-15. These arguments devolve to the point that the City Council, or any other retail regulatory body exercising jurisdiction over a holding company affiliate, apparently may take no action which inhibits or limits a retail operating subsidiary's ability to charge rates that reflect its FERC-assigned payments in retail rates, even if there are legitimate offsets. In other words, FERC-approved wholesale rates become inviolable retail costs for which the State commissions must guarantee recovery, despite findings that the retail utility could have reduced those costs, and that its management was negligent (or worse)

in not doing so.[13]

The "trapped cost" argument confuses the distinct State and Federal roles that the Court in NOPSI III recognized. As the Fifth Circuit found, the City Council has

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[13] Taken to its logical extreme, NOPSI and the Government's arguments appear to create an affirmative obligation on the part of retail regulators to assist the retail utility in recovering wholesale costs which may otherwise render its retail service uneconomic. Consider the following hypothetical: Neither NOPSI or the United States question the City Council's jurisdiction to allocate wholesale costs assigned it by FERC to its respective classes of retail consumers (residential, commercial and industrial ratepayers), by designing rates which recover NOPSI's cost of service. It is entirely possible that under NOPSI's preexisting rate design, the high costs of Grand Gulf power that would normally be allocated to the industrial class would cause some industrials to close their businesses or self-generate, thereby precluding NOPSI from recovering all of its Grand Gulf costs assigned such consumers. In such case, is the City Council bound to redesign NOPSI's retail rates by allocating Grand Gulf costs to the price-inelastic retail classes (e.g. residential) to ensure that no wholesale costs are "trapped?" The logic of NOPSI's and the Government's arguments would create such an obligation on the part of the City Council, or even more perniciously, would lead to FERC's involvement in retail rate design issues as well.

not questioned or sought to regulate NOPSI's wholesale power costs. J.A. at 23. The Council has simply made "the normal ratemaking step of making NOPSI's shareholders rather than ratepayers bear the consequences" of the utility's imprudent actions. NOPSI III, supra, 491 U.S. at 367.[14]

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[14] Despite its participation in the Government's brief, the FERC at one time well understood the distinction between a utility's paying a regulated price and its ability to charge a lawful and reasonable rate. See, Ohio Power Co. v. FERC, 880 F.2d 1400 (D.C. Cir.), rev. sub nom. Arcadia v. Ohio Power Co., 498 U.S. ___, 112 L.Ed.2d 374 (1990). In this litigation, the Commission took the "normal ratemaking step" by seeking to deny Ohio Power the right to recover in its wholesale rates the costs of "captive coal" (i.e. coal produced by a company affiliated with the purchasing utility) also subject to the regulatory authority of the Securities and Exchange Commission under the Public Utility Holding Company Act of 1935. Before the Court of Appeals, the Commission claimed its decision to deny Ohio Power the right to dollar-for-dollar recovery in the utility's wholesale rates of coal costs regulated by the SEC had not "trapped costs". 880 F.2d at 1409-10. In Arcadia, which reversed the Court of Appeals' decision on other grounds, this Court expressed no opinion on the "trapped cost" issue and remanded for further

C. NOPSI's Obligation to Purchase and Not Resell Its Grand Gulf Power

In footnote 43 of its Brief, NOPSI finally alludes to the real issue that lies at the heart of this case: whether FERC's jurisdiction to determine wholesale rates and allocate costs among the retail operating affiliates of a public utility holding company system confers a federal right on the part of the retailers to refuse to resell wholesale power so allocated. NOPSI states that its "facial preemption claim here rests on the valid FERC orders that require NOPSI to buy 17% of Grand Gulf at FERC-approved rates." Pet. Br. at 36, n. 43 (emphasis in original). Left unsaid is NOPSI's apparent conclusion that these FERC orders serve to confer upon it the right to refuse to resell power that it should prudently sell, and be held harmless for that failure.

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proceedings. 112 L.Ed.2d at 387.

In fact, the entire thrust of NOPSI's case, supported by the United States, is that a FERC wholesale rate determination clothes a retail utility in NOPSI's position with an absolute immunity from any retail rate order which fails to provide the utility the right to bill its ratepayers for its purchased power costs. As discussed supra at n. 13, this "right not to resell" argument provides utilities such as NOPSI with the ability to sit on their hands and demand that its retail regulators ensure that all actions are taken which insulate the company from all market risks that the wholesale allocation may cause.[15] Clearly, under any reading of this Court's

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[15] It also apparently gives a utility the right to mislead its retail regulatory commissions. In this case, NOPSI executives testified before the City Council that the utility could and would resell Grand Gulf power if appropriate. J.A. 142-43. Of course, now NOPSI asserts that despite these earlier representations, it enjoys the equivalent of an absolute federal right not to resell, or be penalized for its failure to do so.

NOPSI III characterization of the Council's regulatory response to the passthrough of the costs of Grand Gulf, utilities such as NOPSI are not provided with blanket protection from their retail regulatory commission's responsibility to ensure reasonable and economical utility service.[16]

It is important for the Court to understand the relative roles that FERC and the State and local commissions play with respect to the regulation of retail utilities, even in the case of operating subsidiaries of public utility holding companies. Nationwide, the vast majority of utility investment is carried as retail

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16 We agree that this case does not involve any claim that NOPSI could avoid taking its share of Grand Gulf power and costs. Clearly, under the FERC allocation order, NOPSI has no choice but to accept and pay for its share of Grand Gulf capacity. Accordingly, so-called Pike County issues do not arise in this case. Pike County Light & Power Co. v. Pennsylvania Public Utility Commission, 465 A.2d 735 (1983).

assets subject to the jurisdiction of State and local commissions. By contrast, FERC's regulatory jurisdiction is expressly limited by the provisions of the Federal Power Act to specifically exclude generation facilities, and by omission, any activities that utilities conduct on the "demand side" of the retail meter.[17]

Stated differently, even the retail affiliates of holding companies maintain substantial assets subject to retail rate regulation, conduct or fail to conduct programs to promote their customers' efficient use of electric power, and allocate a utility's costs of service among

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17 It is principally the States that assess a retail utility's need for, and the prudence of, power supply transactions, whether they be construction of plant for "retail rate base" or wholesale purchases from off-system. Tierney, Pre-Approval of Resources: A New Direction for Regulation in Massachusetts, Electricity Journal 26 (Dec. 1990). Thus, NOPSI's assertion that "FERC alone determines the reasonableness of bulk power supply arrangements" (NOPSI Br. at 29) is, at best, uninformed.

various customer classes.[18] Indeed, State and local regulatory commissions have begun a process of regulatory reform, dubbed least cost planning or integrated resource planning, with the goal of promoting utility consideration of all potential demand and supply-side options (including power purchased at wholesale) to develop a portfolio of sources which will result in the most economical level of service.

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18 See n. 14, supra, concerning rate design issues. State and local regulation of retail rate design is particularly important in the context of this case because it is directly analogous to the allocation decision that FERC made with respect to Grand Gulf output. Routinely, State regulatory bodies reach reasoned decisions which allocate retail costs to different ratepayers based on a host of factors. Such allocations may take into account the ability of the retail utility to recover some of its costs from nonjurisdictional customers, i.e. through off-system sales and resales of power. NOPSI and the Government's arguments obviously threaten State regulation of a utility's off-system sales decisions, but also, carried to their logical conclusion, raise substantial questions concerning interclass allocations at the retail level, particularly between price elastic and inelastic customers.

NOPSI's and the Government's arguments in this case run entirely counter to this growing trend, which ironically enough, was triggered in large measure by the adoption of pro-competitive Federal regulatory policies. At the end of its decision in Duquesne Light, supra, the Court alluded to impending changes in the structure of the electric utility industry which will inevitably affect regulation of retail rates and services. Beginning in 1978 with the passage of Section 210 of the Public Utility Regulatory Policies Act of 1978, codified at 16 U.S.C. sec. 824a-3 (1985)(PURPA), policies at both the Federal and State levels have begun to erode the monopoly characteristics of electric utility control of generating capacity.[19] PURPA reduced barriers to entry which had previously

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19 See Federal Energy Regulatory Commission v. Mississippi, 456 U.S. 742, 750-751 (1982) for a description of the deregulatory goals of PURPA.

prevented non-utility cogenerators and small power producers from selling power into electric distribution markets. In recent years, the FERC has proposed to reduce its wholesale regulation of so-called independent power producers--non-utility generators with no distribution facilities or retail customers.[20] This FERC initiative, which is pending at the Commission, reflects the development of new methods of regulation at the State level which seek to inject greater competition into generating markets. State commissions have begun to experiment with competitive bidding systems in which utilities conduct auctions to acquire access to third-party generating capacity for service to retail

[20] See Notice of Proposed Rulemaking, Regulations Governing Independent Power Producers, IV F.E.R.C. Stats. & Regs. para. 32,456, 53 Fed. Reg. 9327 (1988).

consumers.[21] Patterned on PURPA, these State bidding programs seek to encourage utilities to consider third-party producers in order to acquire incremental generating capacity at the lowest available cost.[22]

Necessarily, these complex new State initiatives will require a period of experimentation. Further, because many of these programs involve efforts to rely upon the growing number of competitors in wholesale power markets, new State resource acquisition plans can be expected to raise "federal issues", including questions involving the reasonableness of passing through the costs of bulk power purchases in retail rates.

Therefore, a great deal is a stake in

[21] See Notice of Proposed Rulemaking, Regulations Governing Bidding Programs, IV F.E.R.C. Stats. & Regs. para. 32,455, 53 Fed. Reg. 9324 (1988).

[22] See Griggs, Competitive Bidding and Independent Power Producers: Is Deregulation Coming to the Electric Utility Industry?, 9 Energy L.J. 415 (1988).

this case. NOPSI's argument -- that the Council cannot interfere with its apparent right to sit on the sidelines of the emerging market, to not make choices, and to not sell Grand Gulf power off-system -- directly contradicts the forces of competition and choice which are changing the nature of retail rate regulation. Because of its limited jurisdiction under the Federal Power Act, FERC is in no position to regulate these choices, or provide a utility with a shield to protect it from making such choices, beyond the Commission's responsibility to ensure that its wholesale pricing and transmission policies do not inhibit emerging competitive options for meeting the needs of retail consumers.[23] This Court must not sanction a

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[23] In its decision on remand from this Court's opinion in NOPSI III, the Fifth Circuit rejected NOPSI's claim that it had an obligation to examine "the Council members' motivation in making the order." J.A. 30. Quite properly, the Court below ruled that its examination of the "pretext"

system of concurrent State/Federal regulation which inhibits those choices as well.

In sum, the NARUC respectfully urges the Court to affirm the State's historic "substantial, legitimate interest in regulating retail rates,"[24] by rejecting Petitioner's sweeping arguments. The Court must preserve the lawful authority of State and local governments to ensure that retail

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claim "is inevitably a review of the sufficiency of the evidence to support the Council's stated reasons for denying the pass through," and accordingly, the Council's "motivation is not relevant." J.A. 30-31.

Before this Court, NOPSI and its supporters do not explicitly press the "pretext" claim. However, the NARUC respectfully urges the Court to firmly reject any suggestion that Federal courts be given a roving commission to review and judge the motives of State regulatory officials simply because wholesale power purchases are at issue. Clearly, in NOPSI III, this Court limited lower courts to such objective issues as "industry practice, wholesale rates, and power availability," and did not sanction an open-ended investigation of the thought processes of State and local officials. 491 U.S. at 363.

[24] NOPSI III, supra, 491 U.S. at 365.

utility rates and conditions of service are in the public interest.

CONCLUSION

The Court should affirm the judgment below.

Respectfully submitted,

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NEW ORLEANS PUBLIC SERVICE, INC.,
Petitioner,

v.

COUNCIL OF THE CITY OF NEW ORLEANS, et al.,
Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF OF THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA AND THE PUBLIC UTILITY COMMISSION OF THE STATE OF OREGON AS AMICI CURIAE IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Does a State or local regulatory agency have jurisdiction to find a utility subsidiary of a multistate holding company imprudent in failing to avail itself of the opportunity to reduce its financial and operational risks and protect its ratepayers by diversifying its power supply?

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
TABLE OF CONTENTS	ii
TABLE OF AUTHORITIES	iii
INTEREST OF AMICI CURIAE	2
SUMMARY OF ARGUMENT	3
ARGUMENT	4
A. THE COUNCIL'S INQUIRY IS DISTINGUISHABLE FROM THE INQUIRIES HELD PREEMPTED IN *MISSISSIPPI POWER & LIGHT* AND *NANTAHALA*.	4
1. FERC lacks jurisdiction to decide whether NOPSI prudently managed its power supply.	4
2. No potential for overlapping reviews and conflicting orders exists where state and federal authorities address different issues	6
B. REVERSING THE FIFTH CIRCUIT AND FORECLOSING STATES FROM REVIEWING UTILITY POWER SUPPLY CHOICES WOULD CREATE A REGULATORY GAP.	7
CONCLUSION	9

TABLE OF AUTHORITIES

Cases

	Page
Alliance for Affordable Energy Inc. v. Council of New Orleans, 578 S.2d 941 (La.Ct. App. 1991)	8
Federal Power Com'n. v. Southern Cal Edison Co., 376 U.S. 205 (1964)	4
Kentucky W. Va. Gas Co. v. Pa. Pub. Util. Com'n., 650 F.Supp. 659 (M.D.Pa. 1986), *aff'd.*, 837 F.2d 600 (3rd Cir. 1988) *cert. den.*, 109 S.Ct. 365 (1988)	6, 7
Kentucky W. Va. Gas Co. v. Pa. Pub. Util. Com'n., 837 F.2d 600 (3rd Cir. 1988), *cert. denied*, 109 S. Ct. 365 (1988)	6, 7
Mississippi Power & Light Co. v. Mississippi ex rel. Moore, 487 U.S. 354 (1988)	*passim*
Missouri ex rel. Southwestern Bell Tel. Co. v. Public Service Com'n., 262 U.S. 276 (1923)	2
Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953 (1986)	*passim*
New Orleans Public Service, Inc. v. City of New Orleans, 491 U.S. 350 (1989)	*passim*
New Orleans Public Service, Inc. v. Council of the City of New Orleans, 911 F.2d 993 (1990)	2, 5, 6

Statutes

Federal Power Act, 16 U.S.C. § 824(b)	4

No. 90-1156

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1991

NEW ORLEANS PUBLIC SERVICE, INC.,
Petitioner,
v.
COUNCIL OF THE CITY OF NEW ORLEANS, et al.,
Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF OF THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA AND THE PUBLIC UTILITY COMMISSION OF THE STATE OF OREGON AS AMICI CURIAE IN SUPPORT OF RESPONDENTS

INTEREST OF THE AMICI CURIAE*

This case is critically important to California and Oregon. We are responsible for ensuring that only reasonable expenses are included in retail rates charged to ratepayers in California and Oregon. In discharging our regulatory responsibilities, we determine whether the practices of a utility in maintaining its power supply are prudent before allowing costs to be recovered in retail rates. Factors considered in this process include the reasonableness of the costs in light of other alternatives and the reasonableness of the utility in managing its power supply. This type of review is a traditional function of retail ratemaking, based on the

* All parties have consented to the filing of this brief and letters of consent have been filed with the Clerk.

well-established principle that costs may be passed on to ratepayers only to the extent they have been prudently incurred. *Missouri ex. rel. Southwestern Bell Tel. Co. v. Public Service Com'n.*, 262 U.S. 276 (1923).

In the aftermath of *Nantahala Power & Light Co. v. Thornburg ("Nantahala")*, 476 U.S. 953 (1986), and *Mississippi Power & Light Co. v. Mississippi ex rel. Moore ("Mississippi Power & Light")*, 487 U.S. 354 (1988), States have faced federal court challenges by utilities regarding state authority to review management choices in administrating power contracts and in pursuing power supply options. Based on the language in *Mississippi Power & Light* and *Nantahala*, utilities have asserted that wholesale power costs are "trapped" whenever a state commission disallows such costs from retail rates, even when the Federal Energy Regulatory Commission ("FERC") has not allocated power among affiliates.[1] Petitioner seeks a ruling in this case that FERC has jurisdiction to review utility procurement practices which are *separate and apart* from a FERC order allocating power and costs among affiliates. Such a ruling may result in claims that States lack authority to review procurement practices of their retail utilities, even nonaffiliated utilities. Such claims, if upheld, could effectively exempt resource planning by utilities from any regulatory review.

The decision of the United States Court of Appeals for the Fifth Circuit in *New Orleans Public Service, Inc. v. Council of the City of New Orleans*, 911 F.2d 993 (1990), correctly found that Congress did not vest FERC with exclusive jurisdiction over all possible prudence issues associated with choices made by a retail utility which is affiliated with a multistate holding company. Where, as in the present case, state review focuses on decisions made independently by the subsidiary utility, federal jurisdiction does not extend to preempt the state prudence inquiry.

State or local regulatory review of the purchasing practices of utilities ensures that they procure reliable, diversified, least cost

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[1] *See, e.g., San Diego Gas & Electric Co. v. The Public Utilities Commission of the State of California*, No. 89-3551-MHP, U.S. District Court, Northern Dist. of Calif., *complaint pending*.

sources of power. Utilities, whether affiliated with multistate systems or not, may rely on reversal of the Fifth Circuit's opinion to assert that States have no role in reviewing the prudence of utility procurement practices, once FERC has established a wholesale rate or allocation. Such a result would be directly contrary to this Court's rejection of Petitioner's sweeping facial preemption claim in *New Orleans Public Service, Inc. v. Council of City of New Orleans ("NOPSI III")*, 491 U.S. 350, 367 (1989). A clear delineation of the extent of state authority is necessary to affirm the obligation of utilities to continue to manage power supply in a reasonable fashion even when FERC has allocated costs of a power source to subsidiaries of a multistate holding company. We submit this brief as *amici curiae* to urge the Court to affirm the decision of the Fifth Circuit.

SUMMARY OF ARGUMENT

This case presents the issue of whether a state or local regulatory agency has jurisdiction to find a utility subsidiary of a multistate holding company imprudent in failing to avail itself of the opportunity to reduce its financial and operational risks and protect its ratepayers by diversifying its power supply. Under the rule established by *Mississippi Power & Light* and *Nantahala*, States cannot disturb the allocation of power FERC has mandated. States are also prohibited from interfering with FERC's authority to set wholesale rates or second-guessing FERC's approval of the decision of a holding company and its affiliates to participate in the construction of a generating plant. This said, *Mississippi Power & Light* and *Nantahala* do not abrogate existing state jurisdiction to review other issues of prudence affecting retail rates, independent of transactions among affiliates. This Court has stated emphatically that examining whether a utility has prudently diversified its supply portfolio and imposing costs of imprudent decisions on utility shareholders is not "directly or *even indirectly* foreclosed by the federal statute, the regulations implementing it, or the case law applying it." *NOPSI III, supra*, 491 U.S. at 367 (emphasis added). In *NOPSI III*, this Court found, under the same essential facts as in this case, that the Council of the City of New Orleans ("Council") did not directly or indi-

rectly attack the FERC-set allocation or rate, or examine the prudence of New Orleans Public Service, Inc.'s ("NOPSI") agreement to participate in the Grand Gulf nuclear power plant in the first place. *Id.*

The Fifth Circuit's opinion in no way conflicts with *Mississippi Power & Light* and *Nantahala*. In those decisions, the States asserted jurisdiction over issues which either were or could have been raised before FERC. The prudence inquiries held preempted in these cases involved transactions *among* affiliates. In the present proceeding, by contrast, the Council reviewed decisions which NOPSI made *independently* of its affiliates. Moreover, NOPSI was not legally prohibited by the terms of the system agreement from reselling part of the nuclear power allocated to it by FERC to other utilities.

ARGUMENT

A. THE COUNCIL'S INQUIRY IS DISTINGUISHABLE FROM THE INQUIRIES HELD PREEMPTED IN *MISSISSIPPI POWER & LIGHT* AND *NANTAHALA*.

1. FERC lacks jurisdiction to decide whether NOPSI prudently managed its power supply.

Congress gave FERC jurisdiction over sales of wholesale power but reserved to the States the right to review the retail activities of electric utilities. *Federal Power Com'n v. Southern Cal. Edison Co.*, 376 U.S. 205, 214 (1964). This reservation of authority is set forth in the statute itself. FERC's jurisdiction "extends only to those matters which are not subject to regulation by the States." (16 U.S.C. § 824(b)(1).) Traditional state responsibilities include review of the reasonableness of utility procurement practices including diversification of power supply.

Unlike the questions at issue in *Mississippi Power & Light*, FERC cannot undertake the inquiry which was the basis of the Council's disallowance. The Council addressed NOPSI's failure to reduce its risks (and rates) by pursuing off-system sales. No wholesale off-system sales were in fact made. FERC's jurisdiction to review the prudence of the wholesale purchaser does not extend

to review issues of procurement for a retail utility. FERC's allocation proceeding related only to transactions *among* affiliates.

In *Mississippi Power & Light*, this Court found that FERC had jurisdiction over transactions among affiliates regarding the Grand Gulf nuclear power plant. In contrast, the Council's disallowance was based on NOPSI's *independent* failure to act to diversify its power supply. The Council accepted the costs allocated to NOPSI by FERC and assumed in its proceeding that NOPSI was obligated to pay these costs. The Council reviewed what options were available to NOPSI in the context of its independent role as a retail utility responsible for ensuring the least-expensive, reliable supply of power for its ratepayers. The Council found that NOPSI failed to pursue selling some of the Grand Gulf power to other utilities and replacing it with lower cost coal-fired power. These options were *unrelated* to the system agreement reviewed by FERC. The Council then fashioned its disallowance based on the savings NOPSI could have gained for its ratepayers had it pursued the very off-system sales option it had proposed.

The Solicitor General argues that FERC has jurisdiction over all possible prudence issues related to the allocation of the Grand Gulf nuclear power plant, including whether NOPSI should have sold a portion of its anticipated allotment of nuclear power to other utilities. Both this Court and the Court of Appeals for the Fifth Circuit, however, have recognized that the issue that the Council reviewed is separate and distinct from those issues which the Supreme Court found in *Mississippi Power & Light* could have been raised but were not before FERC. *NOPSI III, supra,* 491 U.S. at 367; *New Orleans Public Service, Inc. v. Council of the City of New Orleans, supra,* 911 F.2d at 993. In short, the issue of whether a retail utility has properly managed its power supply is both logically and legally distinct from whether a subsidiary utility of a multistate holding company has fulfilled its system responsibilities.

In *NOPSI III*, this Court stated that nothing in federal law preempts the action taken by the Council in imposing the costs of imprudent management on NOPSI's shareholders. The Fifth Circuit relied heavily on *NOPSI III* in declining to find, without a firmer statement of Congressional intent, that the matter ad-

dressed by the Council had been committed to FERC's exclusive jurisdiction. *New Orleans Public Service, Inc. v. Council of New Orleans, supra*, 911 F.2d at 1002. Where FERC has no authority to address particular issues, such as the failure of a utility to diversify its power supply by making off-system sales to unrelated entities and replacing it with lower-priced coal-fired power, the jurisdiction is reserved to the States. *Id.*

2. No potential for overlapping reviews and conflicting orders exists where state and federal authorities address different issues.

The FERC's assertion of authority over prudence-related issues arising from transactions *among* affiliates in an integrated system is logical. For the State to focus on choices made by the wholesale buyer in setting retail rates, a distinct "buyer" and a distinct "seller" must exist. Otherwise, the State might in its review duplicate issues raised in the FERC's review of transactions among affiliates. Such duplication might occur in power pooling arrangements involving affiliated companies, in which the distinction between the wholesaler as buyer and the wholesaler as seller may become blurred. Thus, an affiliated utility could be at one time a "buyer" and at another time a "seller". In such circumstances, where there is a single entity, simultaneously serving as wholesaler and retailer, orders from federal and state authorities may conflict and costs become trapped. *Kentucky W. Va. Gas Co. v. Pa. Pub. Util. Com'n.*, 650 F.Supp. 659, 665-66 (M.D.Pa. 1986), *aff'd.*, 837 F.2d 600 (3rd Cir. 1988), *cert. denied*, 109 S.Ct. 365 (1988). Furthermore, in the multistate holding company situation, "[I]t is entirely reasonable to think that the fairness of rates and contracts relating to *joint ventures among* affiliated companies cannot be separated from an inquiry into the prudence of each affiliate's participation." *Mississippi Power & Light, supra*, 487 U.S. at 382 (emphasis added), concurring opinion of Justice Scalia.

The need for a neutral federal forum disappears once transactions among affiliates are no longer involved. Where affiliates act as stand-alone utilities, the potential for duplication of review disappears. FERC approval of allocation of power and rates for subsidiaries of a multistate holding company sharing a power

source or of the agreement to participate in construction does not absolve the purchasing utility from the responsibility to manage its share of the resulting power supply in a prudent manner.

The Council did not review the prudence of transactions among affiliates. Instead, the Council focused on NOPSI's available choices as an independent utility to purchase and sell power. Under these circumstances, where the state and federal authorities address different issues, no potential for overlapping reviews and conflicting orders exists.

Moreover, unlike its regulatory counterparts in *Mississippi Power & Light* and *Nantahala*, the Council did *not* attempt to revise the FERC's allocation so as to shift costs to ratepayers of other States. Off-system sales of power by NOPSI in 1980 would not have affected either the wholesale rate or allocation set by FERC in 1985. Similarly, review of NOPSI's failure to pursue diversifying its power supply did not affect NOPSI's affiliates. The Council's disallowance impacted only the ratepayers and shareholders of NOPSI. As this Court has noted, if the State finds imprudence, the State may take the normal ratemaking step of making the shareholders rather than the ratepayers absorb the excessive costs. *NOPSI III, supra*, 491 U.S. at 367; *see also Kentucky W. Va. Gas Co. v. Pa. Pub. Util. Com'n., supra*, 837 F.2d at 609.

B. REVERSING THE FIFTH CIRCUIT AND FORECLOSING STATES FROM REVIEWING UTILITY POWER SUPPLY CHOICES WOULD CREATE A REGULATORY GAP.

This Court has stated that a State's review of the reasonableness of a utility's purchases of power would not be preempted ". . . if [the utility] had the legal right to refuse to buy that power." *Mississippi Power & Light, supra*, 487 U.S. at 374. In a situation where a utility has no choice, costs could be unfairly trapped if a State evaluated the reasonableness of the utility's actions. If the utility had a *choice* whether or not to purchase power (or to sell power off-system), however, the State may determine whether the utility exercised that choice prudently before passing through the costs in retail rates.

In the instant case, the system agreement reviewed by FERC did not prohibit NOPSI from diversifying its power supply. Indeed, the Council found, based on what one appellate court has found to be a "preponderance" of the evidence, *Alliance for Affordable Energy Inc. v. Council of New Orleans*, 578 S.2d 941, 964 (La.Ct. App. 1991), that NOPSI had the ability to sell part of its Grand Gulf nuclear power off-system and replace it with lower-cost coal, but failed to avail itself of this opportunity. NOPSI had a choice and the Council concluded that it failed to choose prudently.

To reverse the Fifth Circuit and prohibit States from reviewing procurement practices where a utility has the ability to pursue various options would result in a regulatory gap. This result cannot be squared with the definitive language this Court used in *NOPSI III* upholding the ability of local governments to review utility management of power supply, even where the utility is a subsidiary in a multistate holding company. Furthermore, reversal of the Fifth Circuit could be used by *any* utility, including nonaffiliated utilities, as a shield to prevent state review of utility power procurement decisions. By contrast, affirming the Fifth Circuit's decision will underscore utility responsibility to manage wisely where choices are available.

To fulfill its responsibility to ratepayers, utility management must be held accountable for failure to take advantage of opportunities to reduce retail rates. FERC approval of wholesale rates and allocations does not eradicate utility responsibility to procure reliable, least-cost sources of power and to reduce financial and operational risks associated with excessive reliance on a particular technology or fuel. State review of utility choices in these areas does not intrude upon FERC's exclusive jurisdiction over prudence issues arising from transactions among affiliates.

CONCLUSION

For the foregoing reasons, the judgment of the United States Court of Appeals for the Fifth Circuit should be affirmed.

Respectfully submitted,

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